VIEWPOINT

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After *Wayfair*: Modernizing State Sales Tax Systems

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In this article, the authors argue that the *Wayfair* decision will make only a modest dent in reducing the overall complexity and inefficiency in state sales and use tax systems, and that true efficiencies and equities will only occur when the states and the business community recognize their mutual self-interest in modernizing sales and use tax administration.

To the surprise of many, the U.S. Supreme Court in January agreed to review *South Dakota v. Wayfair Inc.*,[1] a case that directly challenges the Court's landmark 1992 decision in *Quill v. North Dakota.* In *Quill*, the Court found that requiring catalog sellers with no physical presence in a state to comply with complex and nonuniform state sales tax collection rules places an unconstitutional burden on interstate commerce. Although the Court's review shines a bright light on the intersection of state sales tax enforcement and internet commerce, the case also offers a larger opportunity to examine the overall efficiency of state sales tax systems as they interact with our growing digital and global economy.

Over the last quarter century, the *Quill* decision established the scope of the debate over the fairness and efficiency of state sales taxes. By focusing on "burdens" imposed on interstate commerce, *Quill* linked a mandated collection responsibility for remote sellers (and thus a "level playing field" for bricks-and-mortar retailers) with sales tax simplification and uniformity.[2] Heeding *Quill*'s admonitions, state governments and multistate businesses in the ensuing years engaged in efforts to improve state sales tax systems by harmonizing definitions and simplifying procedural requirements in a collective process that came to be known as "streamlining" the sales tax.

The Streamlined Sales Tax Project, initiated by the National Governors Association and the National Conference of State Legislatures in the fall of 1999, created the Streamlined Sales and Use Tax Agreement, which was initially adopted in 2002 and later enacted by 23 states

[1] S. Ct. Dkt. No. 17-494.

[2] While the *Quill* decision spoke primarily in terms of "undue burdens" on interstate commerce, the U.S. Supreme Court more clearly stated its concerns in *National Bellas Hess*: "The many variations in rates of tax, in allowable exemptions, and in administrative and recordkeeping requirements could entangle National'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.' . . . The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements." *National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753, 759-60 (1967). *See also Quill Corp. v. North Dakota*, 504 U.S. 298, 314-15 (1992) ("[T]he bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause. Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation.").

and Washington.[3] Similarly, the *Quill* decision was the catalyst for numerous legislative proposals in the U.S. Congress authorizing states to impose a sales and use tax collection responsibility on remote sellers, but only after adopting legislation with a mandated level of sales tax simplification and uniformity.[4]

In recent years, these joint government and business initiatives have stalled. The SSUTA project initially made great strides, but over the last four years no new states have adopted it. Moreover, the top six sales tax collection states by population — California, Texas, Florida, New York, Illinois, and Pennsylvania (comprising 41 percent of the nation) — have declined to join the uniformity project. Similarly, despite reams of testimony, dozens of legislative proposals, and many congressional hearings, no federal legislation has been enacted that would validate the Supreme Court's acknowledgement in *Quill* 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."[5]

Into this void, the Supreme Court has reentered the fray by accepting the *Wayfair* case. It is widely believed that the Court would do so only if it intended to end the "physical presence" requirement in *Quill* as it applies to sales and use tax collection responsibilities.[6] It appears the Court has run out of patience waiting for congressional preemption that balances the two goals of creating a level playing field through mandated collection responsibility and reducing the burdens on interstate commerce through sales tax simplification and uniformity.[7]

If the Court affirms some form of an "economic presence" test, it will likely base its decision on technological advances that purportedly reduce burdens by facilitating multistate sales tax compliance through digital data collection and internet-enhanced software compliance solutions. As 41 states (and D.C.) state in their amicus brief in support of South Dakota in *Wayfair*, "The Internet and modern software — the very same technology that allows online retailers to flourish in the first place — enables retailers to automatically generate the required tax returns and electronically file those returns with ease. . . . Today, with the Internet's near-ubiquitous use by retailers, the burden of collection (if any) has become miniscule. . . . The very technology that makes online retailers so successful at targeting their customers also allows them to collect and remit the owed sales tax through an automated process that requires minimal effort."[8]

South Dakota, as petitioner, and many amici supporting the state position, presented similar arguments about technological breakthroughs

[3] This detailed 124-page agreement includes provisions on uniformity in sales tax base definitions and sourcing rules; simplified tax returns, exemption certificates, and tax rates; state-level administration of sales and use tax collections; and a centrally administered electronic registration system for all member states. *See* Streamlined Sales and Use Tax Agreement (adopted Nov. 12, 2002, and amended through Dec. 19, 2017).

[4] COST has been an active participant in both the SSUTA project and in advocating for federal legislation to create a level playing field for all retailers once the burdens on interstate commerce have been reduced. *See* COST Policy Position: "Simplification of the Sales, Use or Similar Transaction Tax System."

[5] *Quill Corp.*, 504 U.S. at 318.

[6] *See Direct Marketing Association v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring) ("Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier. It should be left in place only if a powerful showing can be made that its rationale is still correct.") (citation omitted). *See also Direct Marketing Association v. Brohl*, 814 F.3d 1129, 1148 (10th Cir. 2016) (Gorsuch, J., concurring) (noting that "*Quill* is among the most contentious of all dormant commerce clause cases" and has "been the target of criticism over many years from many quarters, including from many members of the Supreme Court").

[7] COST did not file an amicus brief in *Wayfair*. Virtually all COST members support both (1) providing a level playing field between bricks-and-mortar retailers and remote sellers through mandated collection responsibility and (2) reducing the "burdens" on interstate commerce through sales tax simplification and uniformity. Nonetheless, there is a split in the COST membership on how closely to link these goals. Many members believe the commerce clause threshold requirement for simplification is much lower than the optimal level of simplification and uniformity prescribed by sound public policy principles.

[8] Brief for Colorado and 40 Other States, Two United States Territories, and the District of Columbia as Amici Curiae Supporting Petitioner, at 3-4, 22-23, 26-27, *South Dakota v. Wayfair Inc.*, No. 17-494.

that reduce the costs of multistate sales tax collection.[9] What these arguments have in common is their singular focus on the back end of the sales and use tax collection process: the calculation of tax and filing of returns.

However, attaining a level of simplification that satisfies a constitutional "commerce clause" requirement should not be confused with constructing an efficient and fair modern-day consumption tax system that works across numerous jurisdictions and is adaptable to the challenges of the global economy in the 21st century. Indeed, based on objective criteria, state sales tax systems in the United States are among the most complex and poorly designed consumption taxes in the world. The simplification of the calculation of tax and filing of returns is an important step in the sales and use tax compliance system, but so too are uniform tax base definitions, sourcing rules, and exemption certificates; rules designed to avoid tax "pyramiding"; central state administration of local taxes; fair and even-handed audit and refund procedures; and vendor compensation to reimburse sales and use tax collection costs.

None of these elements of a sound and efficient sales and use tax system are likely to form the basis of the Court's decision in *Wayfair*. The *Wayfair* decision may establish a new rule for the level of simplification that satisfies the commerce clause, but it will scarcely dent the overall complexity and inefficiency in state sales and use tax systems. True efficiencies and equities will only occur when the states and the business community, working collaboratively or through congressional action, recognize their mutual interest in modernizing sales and use tax administration.

It is perhaps too much to expect that commerce clause constraints will pave the way for more optimal state sales tax systems. Given the alarms raised by virtually all state governments (and the U.S. solicitor general)[10] about the infringements on the states' ability to collect revenue from a significant (and growing) segment of internet-based retail commerce, it will not be a surprise if the Supreme Court tailors its decision to a narrower range of sales tax compliance obligations. In doing so, the Court can determine that technological advances have reduced burdens on interstate commerce sufficiently for it to sanction the switch to an economic presence test for sales tax jurisdiction, even if the test constitutes less of a bright-line standard than a physical presence test. Unfortunately, this approach will unintentionally eliminate the monetary incentives for states to work collaboratively with businesses to simplify and harmonize disparate state sales tax systems. And in a world economy in which consumption taxes can be conducive to economic growth (see below), an inefficient, complex, and disharmonized subnational consumption tax will have a detrimental impact on our nation's ability to compete on a global basis.

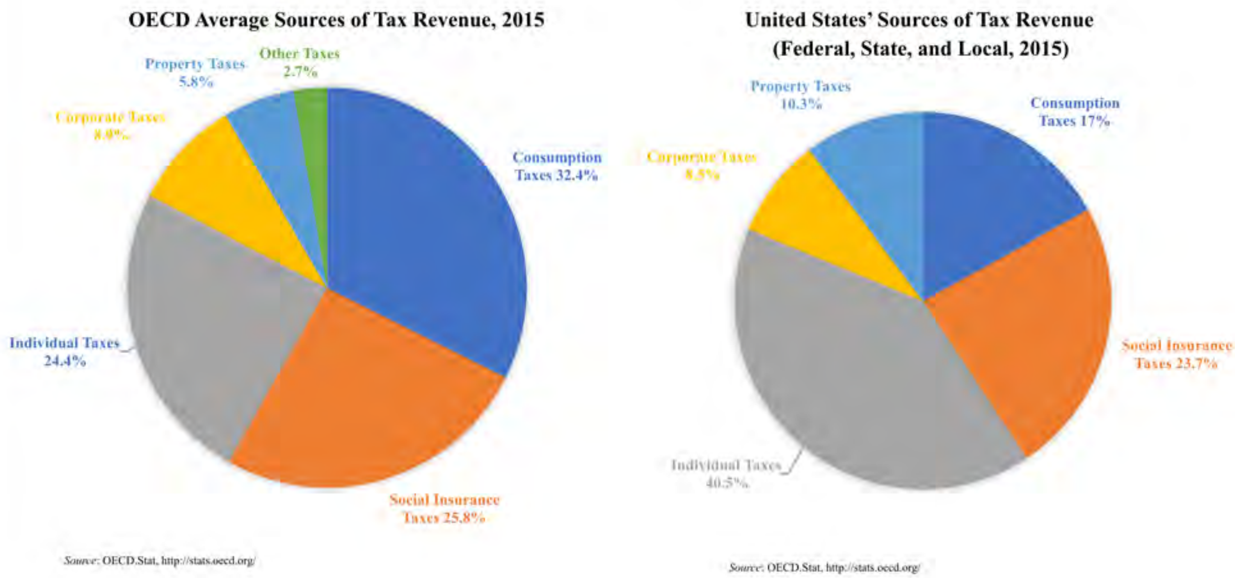
I. The Value of a Well-Designed Consumption Tax

Economists have long debated the relative benefits and burdens of income-based tax systems versus consumption-based tax systems on economic growth and efficiency. In nearly all those debates, consumption-based taxes are the

[9] *See* Petitioner's Brief, at 39, 46, *South Dakota v. Wayfair Inc.*, No. 17-494 (Sales and use tax compliance "is now a problem easily solved through specialized software, [and] achieving nationwide scale rapidly *decreases* the difficulty and expense of multi-jurisdictional compliance. . . . [T]here are now a host of tax-compliance providers with programs that interface directly with e-commerce sites and automate the entire sales tax process."); Brief for the United States as Amici Curiae Supporting Petitioner, at 22-23, *South Dakota v. Wayfair Inc.*, No. 17-494 ("[E]xisting software solutions can significantly mitigate the burdens associated with collecting and remitting state taxes."); and Brief for Amici Curiae Multistate Tax Commission and Federation of Tax Administrators in Support of Petitioner, at 11, *South Dakota v. Wayfair Inc.*, No. 17-494 ("Nor do the same qualitative differences in burdens exist today due to the technology that facilitates calculating, charging, and collecting tax on orders made remotely.").

[10] Brief for the United States as Amici Curiae Supporting Petitioner, at 19-20, *South Dakota v. Wayfair Inc.*, No. 17-494 ("In the absence of laws such as Senate Bill 106, a vast amount of commerce could go unreported and untaxed. The U.S. Census Bureau estimates that retail ecommerce sales in the United States in 2017 totaled more than $452 billion, approximately 9 percent of all retail sales and a 16 percent increase from 2016. The volume of annual e-commerce sales jumps to more than $6.6 trillion when sales by manufacturers, wholesalers, and selected service industries are included. . . . South Dakota reports that it loses between $21 million and $50 million per year in sales tax revenue due to its inability to require out-of-state retailers who lack a physical presence in the State to collect valid state taxes on those transactions. States with larger populations and economies lose even more.") Internal citations omitted.

Figure 1.
Share of Consumption Taxes:
32.4% OECD vs. 17% U.S.



clear winner, for several reasons.[11] Because income taxes are levied on capital income as well as wage income, they impose a direct penalty or disincentive toward savings and investment.[12] This penalty leads to slower accumulation of capital, reduced productivity, and ultimately slower economic growth. True consumption taxes, on the other hand, because they are typically levied on a broad base of personal consumption with exemptions for intermediate business inputs, are viewed by economists as far more neutral in their impact on the economy; that is, they have a much smaller impact on economic decisions to save, invest, or spend. Because the incidence of tax is based on the location of customers and not the location of production, economists generally agree that international tax competitiveness is enhanced by a well-designed consumption tax that does not discourage domestic investment and job creation.[13]

During the buildup to federal tax reform, the Republican House leadership trumpeted the economic benefits of consumption-based taxes. In the influential document "The House Blueprint: A Better Way," published in June 2016, the House Ways and Means Committee stated, "Consumption-based tax systems are widely regarded to be more pro-growth than income-based systems. . . . There is substantial empirical evidence that moving to or toward a consumption-based tax would have significant economic benefits." However, the federal government does not impose a broad-based

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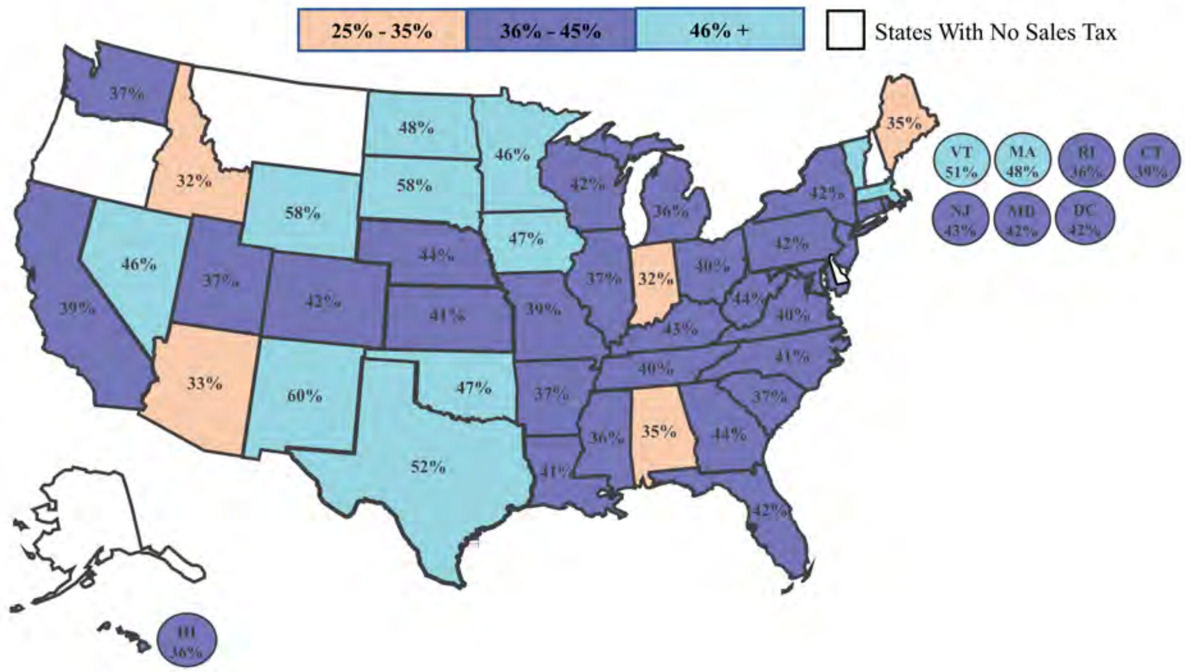
[11] G. Baron Coleman, "The Question Is Not if, but What, We Shall Tax: A History and Comparison of Federal Income and Consumption Taxes and a Look at a Modern Proposal," 9 *Fla. St. U. Bus. Rev.* 1, 2 (2010) (noting that a consensus has emerged among tax scholars in favor of a consumption tax).

[12] Joseph Bankman and David A. Weisbach, "The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax," 58 *Stan. L. Rev.* 1413, 1417 (2006) ("[T]he difference between an income tax and a consumption tax is the taxation of the return to savings or capital income. In a consumption tax, the risk-free return to investing is exempt, while in an income tax, the return is taxed."); *see also* John L. Mikesell, "The American Retail Sales Tax: Considerations on Their Structure, Operations, and Potential as a Foundation or a Federal Sales Tax," 50 *Nat'l Tax J.*, no. 1, 1997, at 151 (advocates of a consumption-based tax system argue that replacing the income tax in the United States with a national consumption tax "would produce '. . . a capital formation boom with strongly increased productivity, higher paying jobs, and new investment from around the world'").

[13] *See* Matthew McMahan, "The International Effects of the Adoption of a Consumption Tax in the United States," 39 *Vand. J. Transnat'l L.* 519, 542 (2006) ("[A]t the international level, the potential short- and long-term economic gains of adopting a consumption tax in the United States enormously outweigh the potentially negative aspects of its adoption.").

Figure 2.
State and Local Sales Taxes Imposed on Business Inputs
Business Inputs Share of Total Sales Tax Collected



consumption tax that could be used as part of federal tax reform. The Republican House leadership was left trying to graft consumption-tax-like principles (for example, the border adjustment provision) on top of a corporate net income tax — a novel proposal that was later dropped in the face of political opposition.[14]

Ironically, the states have recognized the value of relying on consumption rather than production tax principles as a central tenet of sound tax policy — but have applied this axiom not to an appropriate mix of consumption and income taxes, but to the design of a non-consumption tax (that is, the state corporate income tax). Over two-thirds of the states now impose single-sales-factor apportionment or double- or triple-weighted sales factors. Nearly half the states have moved toward market sourcing of services/intangibles (rather than costs of performance). Both of these trends prioritize consumption-tax-type principles, albeit in the context of an income tax.[15]

In some ways, the United States has the worst of both worlds — complex and inefficient state sales tax systems and a lower use of consumption taxes as a share of total taxes. Compared with the other 34 advanced, industrialized nations that make up the OECD, the United States is at the bottom in terms of reliance on consumption taxes as a share of overall taxes. (See Figure 1.) Based on the most recently available OECD data, in 2015 consumption taxes accounted for about 17 percent of all taxes in the United States, compared with 32.4 percent for all OECD countries.[16]

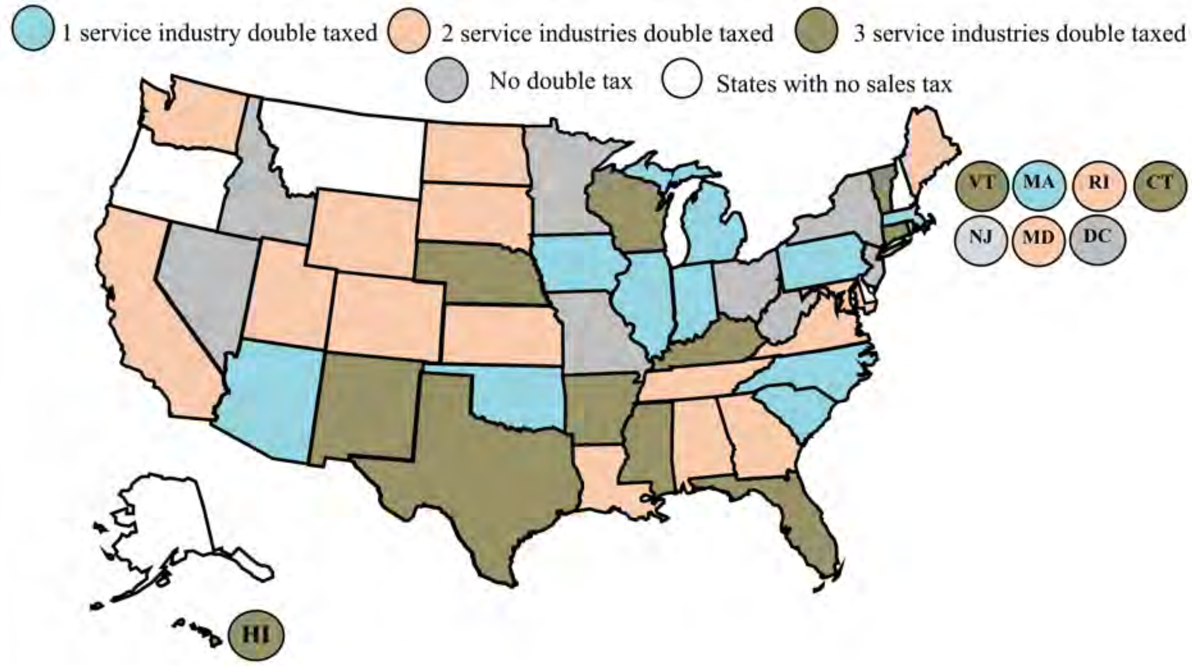
Moreover, over the last 50 years, consumption taxes in the United States as a percentage of GDP

[14] *See* U.S. House Ways and Means Committee, "A Better Way: Our Vision for a Confident America," at 33 (Jun. 24, 2016). Ultimately, the Tax Cuts and Jobs Act (P.L. 115-97) provided significant reductions in federal corporate and personal income taxes but it used deficit financing rather than a shift to another tax type to make up the difference. *See* Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, the 'Tax Cuts and Jobs Act,'" JCX-67-17 (Dec. 18, 2017).

[15] RIA Chart Builder, Mar. 21, 2018. *See also* Che Odom, "More States Move to Market-Based Sourcing, Warts and All," Bloomberg BNA *Daily Tax Report* (Dec. 13, 2016).

[16] OECD, Revenue Statistics — OECD Countries: Comparative Tables: Chapter 3 — Tables 3.7-3.14 — Taxes as % of GDP and % of Total Tax Revenue.

Figure 3.
Double Taxation of Select Service Providers: Wired/Wireless, Cable, Electric + Gas



have decreased by about 19 percent (from 4.7 percent to 3.8 percent), while consumption taxes in all OECD countries, on average, as a percentage of GDP have increased by about 17 percent (from 8.8 percent to 10.3 percent).[17]

In sharp contrast, the United States relies more on taxes on income, profits, and property than most other countries. In 2015 taxes on income and profits accounted for about 49 percent of all taxes in the United States, compared with the OECD average of 34 percent. In that same year, property taxes accounted for about 10 percent of all taxes in the United States, compared with the OECD average of 6 percent.[18]

Viewed from this perspective, the stakes are high for the states as they prepare to enter the post-*Wayfair* (and post-*Quill*) world. The states' laser focus on jurisdictional issues and remote sellers has in many ways obscured the states' long-standing failure to modernize their sales tax systems and, at a minimum, provide a viable option (if politically feasible) to replace taxes on income and property with taxes on consumption.

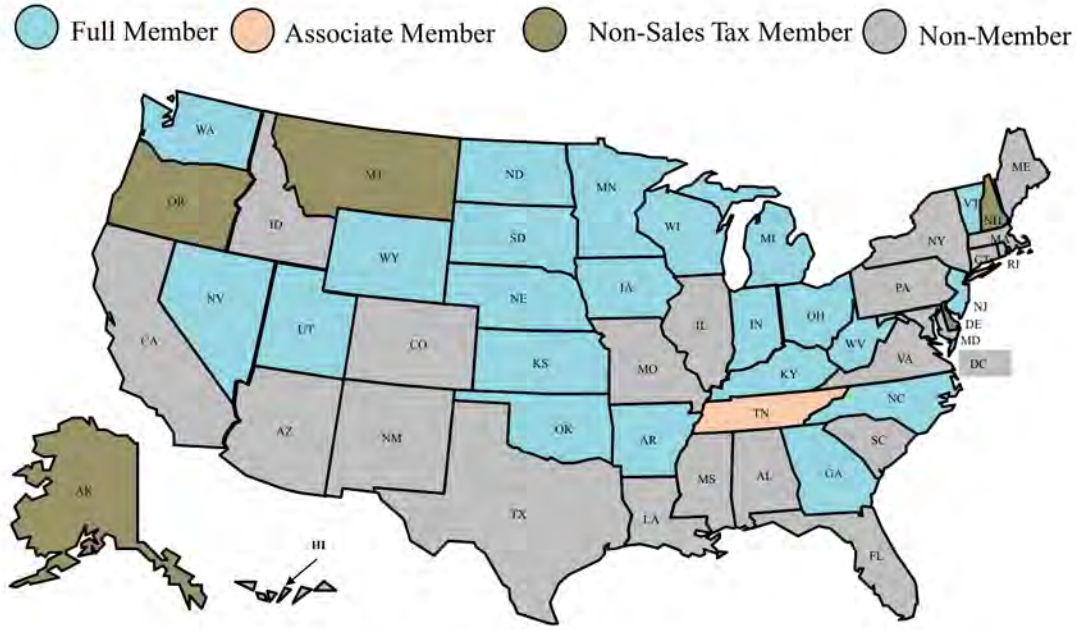
Should the Supreme Court rule in South Dakota's favor in *Wayfair*, statehouses across the country will celebrate. Such an outcome would provide a boost in sales tax revenue[19] and resolve a long-standing irritant for both states and bricks-and-mortar retailers given the more favorable sales tax treatment accorded remote sellers in an economy increasingly shifting to remote sales. But the states should also look toward the future with unobstructed vision: The sales tax jurisdictional/collection responsibility issue is an important one, but the larger structural problems of tax

[17]"Consumption Tax Trends 2016," OECD Publishing, Paris, at 39 (2016).

[18]OECD, Revenue Statistics — OECD Countries: Comparative Tables: Chapter 3 — Tables 3.7-3.14 — Taxes as % of GDP and % of Total Tax Revenue.

[19]The U.S. Government Accountability Office in its November 2017 study on the impact of expanded tax collection authority on remote sales concluded that the annual revenue gain would be between \$8.5 billion and \$13.4 billion in state and local tax revenue. While this is a substantial amount, it constitutes only about 2 to 4 percent of total 2016 state and local sales tax revenue. *See* "States Could Gain Revenue From Expanded Authority, but Businesses Are Likely to Experience Compliance Costs," GAO (Nov. 2017), p. 12.

Figure 4.
Streamlined Sales Tax States



pyramiding, lack of uniformity, and the sheer complexity of state and local sales tax systems pose serious challenges to state tax and fiscal policy in future years. If progress in this arena is not faster than the 50 years it took to resolve the sales tax jurisdictional issues, then both states and businesses are likely to suffer, as may the U.S. economy in terms of international tax competitiveness.

II. Modernizing the State and Local Sales Tax

While consumption taxes in the United States (at all levels) account for only about 17 percent of government revenue, their impact at the state and local level is proportionally more significant. General sales taxes and other excise taxes account for about 35 percent of all state and local taxes.[20] General sales taxes alone account for about 21 percent of all state and local taxes.[21] Thus, regardless of whether the share of consumption taxes in the United States grows relative to other taxes (conforming to global trends), it is critically important to transform existing state sales tax systems so that they operate more in accordance with economic models for growth-enhancing consumption taxes. Listed below are the most glaring inadequacies in the design of state sales tax systems that must be addressed through modernization of sales taxes.

A. Exempting Business Inputs

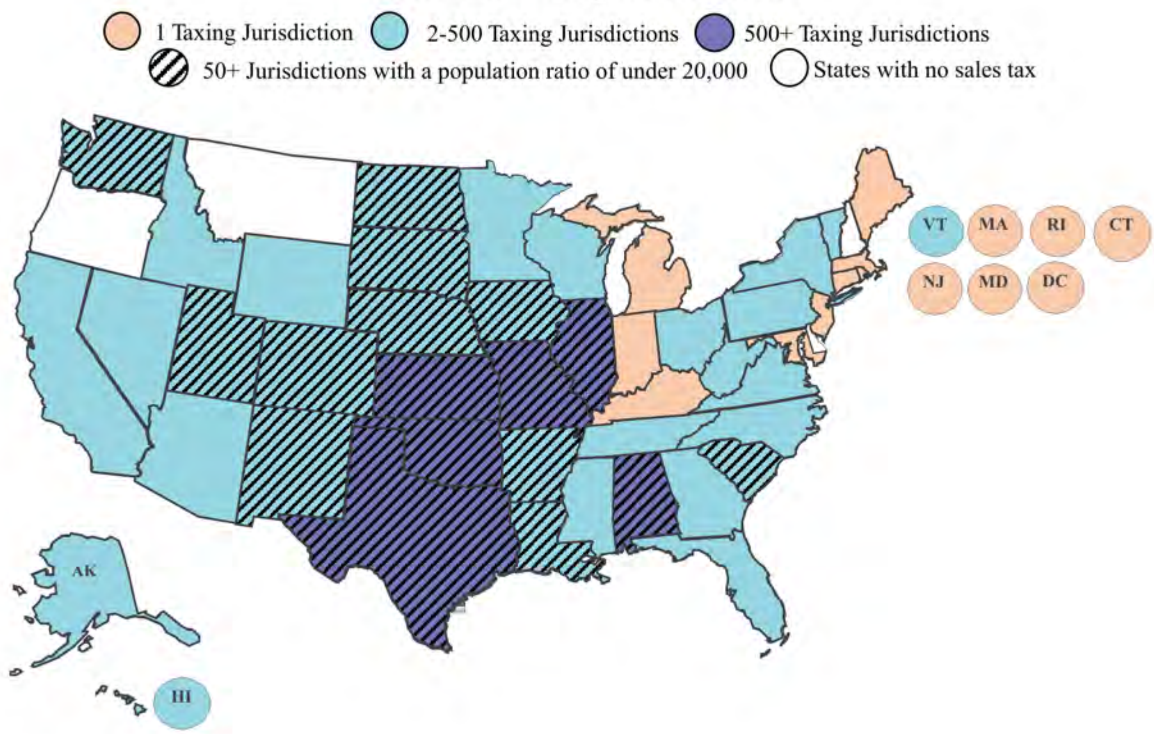
While economists generally agree that the ideal sales tax system would tax final personal consumption and not business-to-business intermediate transactions, U.S. state and local sales tax systems completely violate this principle. States collect, on average, 42 percent of their total sales tax revenue from business inputs.[22] Not a single state has a business share of sales tax lower than Indiana at 32 percent. (See Figure 2.)

[20] Jared Walczak, "Unpacking the State and Local Tax Toolkit: Sources of State and Local Tax Collections," Tax Foundation (June 2017), p. 14.

[21] "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2016," State Tax Research Institute (STRI), Council On State Taxation, and EY (Aug. 2017), p. 4.

[22] Percentages are based on a revised 2016-2017 EY/STRI/COST study on the taxation of business inputs; more detailed report forthcoming in 2018. *See also* COST, *The Best and Worst of Sales Tax Administration* (Apr. 2018, available at COST.org).

Figure 5.
Number of Taxing Jurisdictions



The ramifications of taxing business inputs are significant, including inefficient tax pyramiding, a lack of transparency, higher consumer prices, and reduced economic activity (which can result in lower employment or wages).

Another indication of the excessive taxation of business inputs is the inadequacy of exemptions in many states for purchases of manufacturing equipment and supplies. Manufactured products are ultimately resold, so the equipment, supplies, and materials consumed in a manufacturing operation should generally be exempt from a state's sales tax. While most states provide exemptions for manufacturing equipment and materials, only two states allow broad exemptions for all inputs purchased in the manufacturing process, compared with 12 states that provide no exemptions or allow only significantly restricted exemptions

Other business sectors in which the pyramiding of sales tax is commonplace are service industries such as telecommunications, cable television, and electric and gas utilities. Of the 46 states (including D.C.) with sales taxes, only nine do not double tax any of these three service industries. Ten states double tax one of them, 16 impose a double tax on two of them, and 11 double tax all three. (See Figure 3.)[23]

The pervasive pyramiding of sales tax is a unique feature of the U.S. sales and use tax system. Virtually all other countries avoid the pyramiding of tax by providing exemptions or credits for business inputs when corresponding business outputs are subject to tax.[24]

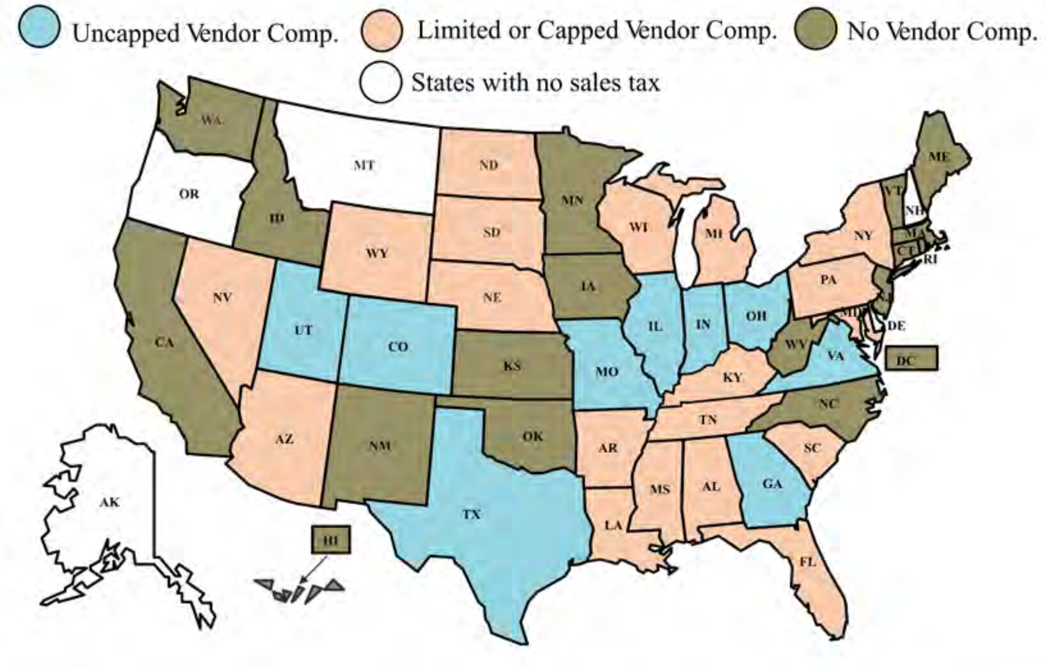
B. Sales Tax Uniformity and Simplification

A second major shortcoming of state and local sales tax systems is the wide divergence among states regarding tax bases, taxable product definitions, and the rules and administrative procedures for collection and remittance. As discussed above, the 23 full member states (and

[23] *Id*.

[24] Most countries achieve this outcome under a VAT system by initially taxing business inputs, but then crediting the amount back to the business purchaser when it collects tax on the corresponding business outputs.

Figure 6.
Vendor Compensation



one associate member state) of the SSUTA have committed themselves to working with other states and the business community to ease the burdens imposed on sellers to collect the states' sales taxes by requiring uniformity and simplification across a wide range of state and local tax administration rules. (See Figure 4.)

Unfortunately, the largest sales tax states have not joined the SSUTA. Indeed, while more than half of all states with sales taxes are members of the SSUTA, nearly two-thirds of the U.S. population live in states that are not members. Thus, businesses in these states do not benefit from the extensive uniformity and simplification contained in the SSUTA.[25] By contrast, the 28 countries in the EU have harmonized not only the definitions of taxable goods and services but also the actual tax bases themselves — leading to much higher levels of consumption tax uniformity in Europe than in the United States.

Many other criteria of fair and efficient sales tax administration are not included within the SSUTA legislation. A sampling of some of these items reinforces the notion that the state and local sales tax continues to be encumbered with inconsistencies, inefficiencies, and unfairness:[26]

- one-third of the states have no liability relief for sellers relying on written guidance provided by a state tax agency;
- more than three-fifths of the states have either no or limited direct-pay permit authority to facilitate self-reporting of sales and use tax by large businesses;
- more than two-thirds of the states allow credits against another state's use tax but not another state's sales tax;
- in four-fifths of the states, the bad debt deduction does not apply to private-label credit cards, which are a common form of consumer payments; and

[25] For instance, the SSUTA states do not burden sellers with the task of policing whether purchased items are exempt from the state's tax under a purchaser exemption or exclusion. Absent a seller committing fraud, states affording exemptions to purchasers should audit the purchasers to determine whether their purchases are exempt from a state's sales tax, and not impose a "good faith" requirement on sellers. A seller should only be required to obtain and retain completed exemption/resale certificates. Unfortunately, 19 of the non-SSUTA sales tax states still impose a good-faith requirement. *See* Streamlined Sales and Use Tax Agreement. *See also* COST, *The Best and Worst of Sales Tax Administration* (Apr. 2018; available at COST.org).

[26] COST, *The Best and Worst of Sales Tax Administration* (Apr. 2018; available at COST.org).

- two-fifths of the states charge higher interest rates on assessments than they pay on refunds.

Finally, states have joined the SSUTA in large measure to reduce the burdens on interstate commerce outlined in *Quill* and thereby ultimately allow mandated sales tax collection by remote sellers. If the Court in *Wayfair* decides technology alone can address these burdens, there remains little incentive for states to continue working collaboratively with the business community to simplify, harmonize, and streamline the effects of disparate state sales tax systems on taxpayers.

C. Centralized Sales Tax Administration

The lack of uniformity in sales tax rules among the states is exacerbated by the large number of localities that impose their own tax rates, and sometimes their own tax base. The sales and use tax is imposed in the United States in 45 states (plus D.C.) and over 10,000 localities. While local autonomy is an important feature of America's unique federalist blend of national and subnational governments, it immeasurably complicates multistate tax compliance. Regarding local jurisdictions, 10 sales tax states have no local tax jurisdictions, 17 have over 100 local tax jurisdictions, and six have over 500 local tax jurisdictions. (See Figure 5.)

State and local sales tax compliance is compounded by those states that allow their local taxing jurisdictions to separately administer the tax or use a different tax base. Colorado, Louisiana, Alabama, and Alaska are outliers, as each relies on local, not state, administration of local taxes. An additional 13 states impose separate local sales tax bases that differ from the state tax base.[27] Here again, the U.S. consumption tax is unique: Most other advanced industrialized countries impose their consumption taxes only at the national level and levy no local consumption taxes.

[27] *Id.*

D. Reasonable Vendor Compensation

Finally, in a more optimal sales tax system, states should provide adequate compensation to vendors for the collection and remittance of sales taxes. A 2006 study conducted by PwC for the Streamlined Sales Tax Governing Board concluded that sellers with annual sales under $1 million incurred average compliance costs of 13.47 percent of the tax remitted, sellers from $1 million to $10 million incurred average compliance costs of 5.2 percent, and sellers over $10 million incurred average compliance costs of 2.17 percent, with a weighted average for all sellers of 3.09 percent.[28] As forced collection agents for the state, it is inequitable for a state to not reimburse sellers for more of their costs to collect and remit state and local sales taxes. (See Figure 6.) Nonetheless, 18 states provide no vendor compensation, 19 states provide some vendor compensation but generally limit it to $12,000 per year, and nine states do not cap vendor compensation but provide only a fraction of the actual costs incurred.[29]

III. COST's Sales and Use Tax Scorecard

To accelerate the modernization of the state and local sales tax and reinforce the mutual benefits for states and multistate businesses in doing so, the Council On State Taxation has developed a Sales and Use Tax Scorecard that evaluates state adherence to sound policy principles for sales taxes.[30] The scorecard focuses on six categories that reflect a broad spectrum of fair, efficient, and uniform sales tax administration practices.[31] While these categories overlap in part with the rules adopted by the SSUTA member states, they encompass a broad range of additional criteria that define an optimal sales tax system.

[28] *See* "Retail Sales Tax Compliance Costs," PwC (Apr. 7, 2006).

[29] *See* former section 608 of the SSUTA.

[30] Since 2001 COST has issued scorecards reviewing the states' overall tax administration. More recently, first in 2007 with its issuance of an unclaimed property laws scorecard and then in 2009 with its issuance of a property tax administrative scorecard, COST has conducted a more detailed review of administrative practices on select areas of state law. COST studies (and those of its research arm, the STRI) are available at COST's website.

[31] The scorecard was published in Apr. 2018. It is broken into the following categories:

The scorecard evaluates state and local sales taxes on their effectiveness in taxing personal consumption (and not business inputs) and on implementing uniform, fair, and centralized administration of state sales taxes. Importantly, the states' differences in tax rates and breadth of the tax base (other than taxing business inputs) are not part of the evaluation, as these are appropriately matters of state sovereignty and political choice.

It is our hope that the scorecard will foster constructive dialogue on the vital importance for both state government and multistate businesses of modernizing the state and local sales tax, and also set forth the particulars of how best to achieve that goal.

Granted, progress toward sales and use tax modernization will not be easy or straightforward. Numerous obstacles remain, including the difficulty of promoting uniformity and enacting legislative reform, the potential loss of political urgency for simplification if the *Quill* precedent is struck down, fiscal challenges to replacing sales tax dollars forgone if business inputs are exempted, and the quagmire of local government sovereignty. But the stakes are simply too high in terms of reduced compliance costs, tax simplification, and enhanced global competitiveness for states and multistate businesses to not expeditiously move toward the goal of sales and use tax modernization. ■