



**NATIONAL RETAIL FEDERATION**

**Sales Tax Collection on Remote Commerce**  
**Achieving a Level Playing Field for all Retailers and Consumers**

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**Submitted to the**  
**Committee on Finance**  
**United States Senate**

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**Statement of Scott Cahill, Vice President, National Retail Federation  
Before the Senate Finance Committee  
On Internet Taxation**

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The National Retail Federation (NRF) appreciates the opportunity to provide comments regarding a possible extension of the Internet Tax Freedom Act (ITFA), and more importantly, how state sales taxes should apply to remote commerce.

By way of background, the National Retail Federation is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 22 million people -- about 1 in 5 American workers -- and registered 2000 sales of \$3.1 trillion. In its role as the retail industry's umbrella group, NRF also represents 32 national and 50 state retail associations.

ELIMINATE THE SALES TAX LOOPHOLE NOW

Retailers oppose any new taxes on the Internet, including any new "access" or "bit" taxes. Legislation to prohibit states from imposing these new taxes on the Internet itself is not objectionable as a substantive matter. What is objectionable is that proposals to extend this moratorium do not eliminate the existing inequity in state sales tax law that unfairly exempts some remote sellers from collecting a states' sales tax. Refusing to address this "sales tax loophole" in the same context as other Internet tax issues ensures that an "uneven tax playing field" will continue to exist for retailers and low-income consumers.

If the ITFA is extended this year without eliminating the sales and use tax inequity, resolution of this inequity, as a practical matter, will be deferred for many years -- perhaps forever. This will lead to a continued erosion of state sales tax revenue, continued discriminatory tax treatment that disadvantages storefront retailers, and intensification of the digital divide. Projected shifts of commerce to the Internet, already evidenced today, will only exacerbate this dilemma and enhance this discrepancy over time.

EXISTING SALES TAX LAW IS UNFAIR

Under current law, retailers are required to collect sales taxes from a customer and immediately remit this tax to the state. However, based on two Supreme Court rulings, some out-of-state retailers (those without a physical presence in the purchaser's state) are not required to collect and remit a state's sales and use tax. Since many Internet sites and remote sellers aren't located in a purchaser's state, they are not required to collect these taxes. Allowing some out-of-state sellers freedom from having to collect sales taxes while requiring their in-state counterparts to do so creates an "uneven playing field" among retailers. **Current sales and use tax law creates an "uneven playing field" among retailers.**

In an industry where a 1-2 percent profit margin is standard, a 6-8 percent tax differential (the average state's sales and use tax rate) is a significant price advantage. Consumers should pick winners and losers based on factors which they decide are important such as selection, service, and convenience. Tax policy should not provide one retailer a pricing advantage over another. **The government should not be in the business of picking winner and losers.**

On average, sales and use taxes account for approximately 40 percent of a state's total tax revenue (more than \$150 billion in 1998). With on-line sales continuing to increase, state and local governments could lose as much as \$20 billion in uncollected sales taxes. Sales tax revenue is used to fund basic state and local governmental services including police and fire protection, school funding, etc. **State and local government services will suffer as their revenue base decreases.**

According to a Commerce Department study, wealthy individuals are 20 times more likely to have Internet access. Unfortunately, single parents, Hispanics and Blacks lag behind in computer ownership. With an average Internet household income of \$70,000, an "unlevel playing field" would benefit those with higher levels of income and shift the tax burden to lower income individuals who can only buy locally (and thus pay sales tax at the sales counter). **An "unlevel playing field" disproportionately hurts the poor.**

### THE THREAT STILL EXISTS

According to the Commerce Department, U.S. e-commerce sales for the first quarter of 2001 were up 33.5 percent from the first quarter of 2000. Despite a slowdown in retail sales in 2000 and 2001, e-commerce sales increased almost 70 percent over 4<sup>th</sup> quarter 1999 to 2000 (the holiday shopping season). Ninety-six million Americans have browsed a website, 68 million have made on-line purchases. Thirty-six million Americans shopped on-line in December of last year, spending an average of \$304.

Despite varying figures, remote sales account for between 3.5 and 6.0 percent of total retail sales. Close to \$50 billion in consumer purchases were made on-line in 2000, while more than \$110 billion were spent on catalog purchases. Books, music, and videos purchased from remote sellers account for more than 10 percent of all retail sales.

Though some high-profile Internet retailers have failed in recent months, remote sales (Internet and catalog) continue to increase. Many of these fledgling companies never adopted a sound retail business strategy, and suffered from that mistake. Retailing is a very competitive business. On average, 15,000-18,000 retailers go out of business every year. The retail industry in general has fallen on hard times, not just Internet retail companies. For example, after more than 125 years in business, Montgomery Wards went out of business in 2001, closing 252 stores and laying off more than 35,000 employees in one day.

No sector of the economy or an industry should be provided with preferential treatment. Retailers only seek equitable tax treatment, regardless of where or how they sell their goods.

### THE SOLUTION – A FEDERAL LEGISLATIVE ROADMAP

Federal legislation must encourage States to simplify their sales and use tax systems in order to minimize the collection burden for all sellers. It is essential that any federal legislation provide States the authority to collect from all remote sellers once this simplification and unification is achieved. More important, this legislation must also provide for tax simplification and expanded state authority to collect in an expedited and detailed manner to ensure that the existing inequity is eliminated.

NRF and interested parties have worked closely with Members of the House and Senate to find an acceptable solution to this problem. Negotiations have included representatives from state and local governments, the high-tech community, and the retail industry. **S. 512, introduced by Senator Byron Dorgan (ND), and H.R. 1410, introduced by Rep. Ernest Istook (OK), both provide the level of sales tax simplification and uniformity needed by both in-state and out-of-state retailers.** Furthermore, these proposals would allow interested states to opt-in to this new system, and ultimately expand their collection authority to remote sellers.

#### EQUITABLE TAX COLLECTION OBLIGATIONS FOR ALL RETAILERS

While NRF opposes the imposition of any new taxes on the use of the Internet or any other channel of distribution, NRF believes all retailers, regardless of the single or multi-channels in which a retailer does business, should be treated equally with respect to collection obligations required by existing state sales and use tax laws. Equity should be ensured regardless of whether the transaction is made in a traditional store, through a traditional store's own website, by a strictly e-commerce retailer or through any other type of remote seller. Tax policy should be channel neutral.

In order to achieve parity, goods purchased from remote sellers should be taxed at the same rate as goods purchased through traditional stores. Congressional action is necessary to allow businesses to operate in an equitable environment that ensures fair competition, protects all consumers, sustains our communities, and addresses simplification of state sales and use tax systems.

#### SALES TAX UNIFORMITY AND SIMPLIFICATION

NRF believes it is important to set forth principles that should guide the effort to create a fair, workable, and simplified sales and use tax system. NRF recognizes that general principles do not always provide answers to specific problems, in part because there is sometimes tension between the implications of such principles. In building a simplified tax system, there will be occasion when one or another of the guiding principles will take precedent over another, at least for a time. Nevertheless, NRF believes that it is important to articulate guiding principles if for no other reason than to have a standard against which to measure the soundness of any proposed simplified sales and use tax regime.

To that end, NRF endorses the following guiding principles, which have been endorsed by the United States government and most other developed nations under the auspices of the Organization for Economic Cooperation and Development (OECD):

Neutrality – taxation should seek to be neutral and equitable between forms of e-commerce and between conventional and electronic commerce, so avoiding double taxation or unintentional non-taxation.

Efficiency – compliance costs to business and administration costs to governments should be minimized as far as practical.

Certainty and simplicity – tax rules should be clear and simple so that both taxpayers and tax collectors understand them.

Effectiveness and fairness – taxation systems should be designed to minimize the possibility of evasion or avoidance.

Flexibility – taxation systems should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.<sup>1</sup>

NRF is committed to creating a fair, workable, and simplified sales and use tax system for the twenty-first century. NRF believes the creation of such a system is critical to the future of a vibrant retail sector in which vigorous competition occurs without regard to artificial tax advantages or barriers. Uniform definitions, a centralized system of registration and tax administration, a limited number of state tax rates, uniform sourcing rules, and vendor compensation are important components addressed in a paper which details NRF's view of the essential elements of a viable sales and use tax system in depth. This detailed list of retail industry prerequisites for sales and use tax simplification is attached in the industry white paper entitled, *The Level Playing Field and Beyond, A Framework for a Fair, Workable, and Sustainable Sales and Use Tax System* (March 2001).

### **The Single-Tax-Rate-Per-State Issue**

Some in the business community have argued that a single sales tax rate per state is necessary for simplification to remove any future collection and compliance burden from retailers. NRF, representing a significant majority of the U.S. retail industry, the very people that will use this new simplified sales tax system, does not believe a single-rate per state is mandatory. Rather, NRF believes that simplification can still be achieved with a limited number of rates per state, assuming the states and locals can agree to adopt uniform definitions for goods and services, limit the frequency of rate changes, and that software is made available to vendors that is capable of synthesizing this information quickly and accurately. It is worth repeating that retailers believe that uniform definitions (uniform base) is the most critical element of any simplification process.

### **New Business Activity Tax (BAT) Standards**

There are concerns by some in the business community that if federal legislation either directly, or indirectly, overturns *Quill's* physical presence precedent, a businesses' exposure to income tax or other BAT taxes could be increased. To address this concern, most legislative proposals (S. 512 and H.R. 1410) detailing simplification criteria, as well as state and local simplification projects, include provisions stating that any sales and use tax collection obligation will not be a factor in determining whether a seller has nexus with a state for any other tax purpose.

Others in the business community, however, see an extension of the ITFA and a possible resolution to the sales tax inequity as an opportunity to provide new bright-line BAT nexus standards in other areas. While the retail industry recognizes some of their concerns, retail does not believe additional BAT provisions should be incorporated into this debate at this time. Reaching a consensus on any new BAT standards at this time will be difficult, and will shift focus away from the primary goal of sales tax simplification and uniformity of state sales tax structures.

### **Offsetting and Measuring Compliance Burdens Under a New Tax System**

Due to the complexity of existing sales and use tax systems, the state and local governments that impose these taxes require an outside third party (i.e. retailers) to collect them at the point of sale from consumers. Retailers must then remit these taxes back to the state or local governments immediately. Retailers expend significant time and resources collecting and remitting the taxes to the appropriate taxing authority and documenting their compliance. The costs of collecting these consumption-based taxes does

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<sup>1</sup> Organization for Economic Cooperation and Development, *Taxation Principles and Electronic Commerce* (1998).

not fall on the states or locals, but rather on retailers who are required by law to act as the taxing jurisdiction's collection agent.

Retailers do not oppose acting as a states' collection agent, however, it is only fair that states provide these mandated vendors with some sort of compensation for the compliance costs associated with collecting and remitting sales taxes. One simple solution to determine what, if any, compliance burden actually exists on vendors would be to undertake a joint state/vendor study to determine the actual costs of collection and remittance of sales and use taxes under the old versus a new sales tax system.

Not only would this study measure compliance burdens under existing state sales tax systems, but it could also quantify the level of simplification achieved when compared to the sales tax simplification provisions which are ultimately adopted. The results of this study would provide legitimate data for the states and vendors as to the actual costs of compliance, and consequently, what compensation should be provided to vendors as the state sales tax simplification process moves forward. The study would be continually updated.

The National Retail Federation, and the U.S. retail industry, looks forward to working with the Senate Finance Committee to address these issues and to find a resolution that eliminates the existing state sales tax inequity.