



NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

TESTIMONY OF
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CO-CHAIR,
NATIONAL CONFERENCE OF STATE LEGISLATURES
TASK FORCE ON STATE AND LOCAL TAXATION OF TELECOMMUNICATIONS AND
ELECTRONIC COMMERCE

ON BEHALF OF THE
NATIONAL CONFERENCE OF STATE LEGISLATURES

REGARDING
CYBERSHOPPING AND SALES TAX: FINDING THE RIGHT MIX
&
S. 512 – THE INTERNET TAX MORATORIUM AND EQUITY ACT

BEFORE THE
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TESTIMONY OF SENATOR STEVEN RASUCEHNBERGER,
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Taxation of Telecommunications and Electronic Commerce

Chairman Baucus, Ranking Member Grassley and members of the Finance Committee, I appreciate the invitation to testify before you today on behalf of the National Conference of State Legislatures. The National Conference of State Legislatures is a bi-partisan organization representing every state legislator from all fifty states and our nation's commonwealths, territories, possessions and the District of Columbia.

I am pleased to have the opportunity to speak to you about state and local taxation of electronic commerce, particularly, the ability of state and local governments to collect the sales and use tax presently owed on transactions which occur on the Internet through remote sellers. Let me make clear, state legislators are not advocating any new taxes on electronic commerce. We desire, however, to create a streamlined sales and use tax collection system to more efficiently collect the transactional taxes legally imposed by our states.

Electronic Commerce and the States

Let me first acknowledge that there is much misinformation being disseminated that state governments view the Internet and Electronic Commerce as a "cash cow" and we, as state officials, are salivating for our prime cut. This is simply not true.

Speaking for my colleagues, we recognize the vital economic force that the Internet and advanced telecommunications services will be for our states and our nation. We also are as concerned as you are about the unintended consequences of obsolete, discriminatory or multiple taxes on this vital new technology.

It is important to note for the record that no state has enacted any Internet specific taxes. In some states where a tax on Internet access was grandfathered by the Internet Tax Freedom Act of 1998, state legislatures have worked to repeal those taxes. For example, the state legislatures in Connecticut and Iowa have voted to do so.

With that said, we need to make clear that state legislatures are equally concerned about the impact that sales tax free electronic commerce transactions will have on state revenues and the unfair competitive burden it will have on small main street businesses, the life blood of many of our small towns and communities. We ask you to consider the words of one of the leading proponents of sales tax reform, Senator Richard Finan, President of the Ohio Senate, in a speech he made to state legislators from across the country, "I am sure many of you each year are asked to help sponsor a little league team or take an ad in a high school yearbook somewhere in your district. Your Main Street retailer does that everyday, every year." Senator Finan continued, "Will AOL-Time Warner, Amazon.com, Microsoft, or Cisco sponsor your son's or daughter's little league team or support your local Boy and Girl Scout troops? I think you know the answer."

Furthermore, the general sales and use tax is our primary consumption tax. This tax provides about one-third of state revenue – over \$150 billion in 1998 – with most of the funds used to finance K-12 education. Of every dollar spent on education in this country, 93 cents come from state and local revenues, and only 7 cents comes from the federal government.

Sales Tax Popularity

As we all know, taxes are not very popular. However, if state and local governments are to provide necessary services, like education and public safety, then we need to maintain our ability to levy taxes. In surveys of taxpayers as to which tax of all the major federal, state and local taxes they dislike the least, the surprising answer has consistently been the sales tax.

Voters all over the country have approved local sales taxes to pay for sports stadiums, added police protection, land acquisition for open space, and transportation improvements. The taxpayers of the state of Michigan overwhelmingly voted to use the sales tax as opposed to property tax as the major source of revenue for education and then the next year, they voted to increase the sales tax.

As you know, the sales tax is imposed on the customer, not the seller. Sellers collect the tax on behalf of state and local governments and pass this money along to them. Some have argued that requiring remote sellers to collect the state and local sales tax amounts

to taxation without representation. This is a specious argument because it is the consumer that pays the sales and use tax to his or her state, not the seller. Many states pay merchants for this service, typically allowing them to keep between 1 and 3 percent of what they collect to offset the administrative cost.

Sales Tax and Electronic Commerce

The problem states have with the sales tax is that the base keeps shrinking. In the 1930s, when the sales tax was first imposed, consumers bought goods from the local merchant and it was not that difficult for the merchant to collect a few cents on the dollar. Also, most Americans spent very little on services – they spent most of their money on taxable goods. And there were very few “remote sellers.”

In the 1970s and 1980s, the share of personal consumption expenditures began to shift from taxable goods to services – things like medical care, health clubs, legal and accounting services. So the sales tax was applied on a smaller and smaller share of tangible products. This was compounded on the goods side by mail order outlets selling goods without collecting sales taxes from their customers – a practice sanctioned by the U.S. Supreme Court in the *National Bellas Hess* case in 1967 and reaffirmed in the *Quill* decision in 1992.

Today, states face a new threat to sales tax revenue, electronic commerce, with the potential to dramatically expand the volume of goods sold to customers without

collection of a sales or use tax. The combined weight of the shift to services and the tax erosion due to electronic commerce threatens the future viability of the sales tax and essential governmental services such as education and public safety.

According to the Center for Business and Economic Research at the University of Tennessee, in 2003 alone states will lose \$ 11 billion in sales tax revenue due to the emergence and growth of electronic commerce. This amount will continue to grow each year. The following is a list of the revenue losses for those states which have a member serving on this Committee:

State	2003 (Electronic Commerce Alone)
Arizona	\$ 183 Million
Arkansas	\$ 101 Million
Florida	\$ 754 Million
Illinois	\$ 454 Million
Iowa	\$ 88 Million
Louisiana	\$ 244 Million
Maine	\$ 42 Million
Massachusetts	\$ 163 Million
Mississippi	\$ 111 Million
New Jersey	\$ 274 Million
New Mexico	\$ 103 Million
North Dakota	\$ 21 Million

Oklahoma	\$ 160 Million
South Dakota	\$ 31 Million
Tennessee	\$ 293 Million
Utah	\$ 85 Million
Vermont	\$ 17 Million
West Virginia	\$ 56 Million

As state legislators, we recognize that we have been part of this problem. We have created a confusing, administratively burdensome tax system with very little regard for the compliance burden placed on multi-state businesses. In 1999, NCSL passed a resolution, written by NCSL's Task Force on State and Local Taxation of Telecommunications and Electronic Commerce, that acknowledged that states need to simplify their sales and use taxes and telecommunications taxes for the 21st Century. We recognize that we have been a key part of the problem – and we also are the solution.

In our resolution, we formulated a set of seven principles that we used to develop a proposal for simplifying and streamlining state and local sales and use tax collection systems. The overriding theme of those seven principles is competitive neutrality. State legislators from across the country unanimously approved this resolution that declared, “state and local tax systems should treat transactions involving goods and services, including telecommunications and electronic commerce, in a competitively neutral manner.” The resolution further stipulated, “that a simplified sales and use tax system that treats all transactions in a competitively neutral manner will strengthen and preserve

the sales and use tax as vital state and local revenue sources and preserve state fiscal sovereignty.”

Streamlined Sales Tax Project

In January of 2000, the NCSL Task Force drafted model legislation directing state revenue departments to join in multistate discussions to develop a simpler, uniform and fairer system of sales and use taxation, that removes the burden imposed on retailers, preserves state sovereignty and enhances the ability of U.S. firms to compete in the global economy. In only the second time in NCSL history, the NCSL Executive Committee approved the model legislation and sent it to the states for consideration in the 2000 legislative sessions. While drafting the model legislation, the Task Force members had felt that between five and ten states joining the multistate discussions would demonstrate a significant commitment on behalf of the states to simplify the admittedly complex sales and use tax systems from state to state. By the end of 2000, 32 states had joined what is now called the Streamlined Sales Tax Project (SSTP) through either legislative or executive action.

The Streamlined Sales Tax Project has met almost monthly since February of 2000 working on recommendations to implement the key features of the Streamlined Sales Tax System. These key features are SIMPLIFICATION of sales and use tax laws and administration; the USE OF TECHNOLOGY for calculating, collecting, reporting and or paying the tax; and STATE ASSUMPTION of the COSTS of the system for remote

sellers. Until Congress grants the states the authority to require collection of sales taxes on remote sales, the system will be voluntary to sellers.

The simplifications of a streamlined sales tax system are:

- Uniform state and local sales tax base;
- Uniform sourcing rule;
- Uniform procedures for exempt transactions;
- Uniform definitions;
- Uniform deduction for bad debts;
- Central, one-stop registration system;
- Limits on the frequency when rate changes may be made;
- Required advanced notice of changes;
- Remittance of tax to state level only, states to remit to the local governments.

Taken as a package, state and local groups believe that such a system will eliminate the undue burden on remote sellers who collect sales and use taxes, while at the same time providing positive reforms for all sellers.

We are pleased to report that these are the same simplifications that are embodied in S. 512, *The Internet Tax Moratorium and Equity Act*, sponsored by Senator Dorgan along with Senators Bennett, Breaux, Chafee, Cleland, Daschle, Durbin, Enzi, Graham, Hutchinson, Hutchison, Johnson, Lincoln, Nelson (Nebraska), Rockefeller, Thomas and Voinovich.

Simplification Process Moving Forward

In January of this year the Streamlined Sales Tax Project issued its recommendations in the form of a model act and an interstate agreement. The NCSL Task Force modified the SSTP act and agreement to provide an alternate measure for legislatures to consider that would allow for greater participation for elected policymakers in the next round of negotiations of the final terms of simplification requirements in the interstate agreement.

Some have portrayed the action by NCSL as a split with the SSTP. However, the changes made to the SSTP model act and agreement were only made to complement the decision making process as the simplification requirements are agreed upon. Let me make perfectly clear, states that acted on either version of the model act will come back to the same table to finalize the ground breaking work that has been done so far.

In a letter to state leaders, signed by the Executive Directors of the National Conference of State Legislatures, the National Governors' Association, the Federation of Tax Administrators and the Multistate Tax Commission, the national organizations made clear the following points:

- **"There is only one state and local sales and use tax simplification effort underway among the states, and there should continue to be only a single simplification effort.** That simplification effort should accommodate the participation of the largest number of states possible. The work of the SSTP and

NCSL are complementary and differ only in the degree of simplification considered achievable in the short term."

- "Each state that passes legislation this year or next committing to development and implementation of a streamlined sales tax system should recognize all other states passing such legislation as equal partners in the continued development of the streamlined system, regardless of whether the measure enacted is based on the SSTP or NCSL version or is some hybrid of the two. The important point is that each state passing such legislation evidences the state's commitment to simplification and uniformity in administration of the sales tax."
- "Those states passing simplification legislation should be considered the 'governing states' for the simplification effort and have authority to finalize an interstate sales and use tax agreement. The governing states should use a one vote per state rule in their deliberations. The composition of the delegation from each state should be determined by the state."

As of July 26, 2001 sixteen states (**Arkansas, Florida, Indiana, Kentucky, Louisiana, Maryland, Minnesota, Nebraska, Nevada, North Dakota, Oklahoma, Rhode Island, Tennessee, Texas, Utah and Wyoming**) have enacted one version of the model act establishing intent to simplify based on the above mentioned principles of the Streamlined Sales Tax System and securing a vote as a "governing state" to finalize the last terms of the agreement. The legislation also has passed both Houses of the legislature in **Illinois and North Carolina** and awaits the signature of their governors.

Action is still pending this year in **Michigan, Ohio, Pennsylvania, Massachusetts and Wisconsin.**

The NCSL, NGA, MTC and FTA will convene the representatives of the "governing states" for their inaugural meeting in late September or early October.

Overcoming seventy-five years of modifications to 46 different sales tax systems will not be an easy task, however, the progress that the states have made collectively over the past two years should make clear my colleagues' level of commitment to simplifying the sales and use tax system.

INTERNET TAX MORATORIUM

The current moratorium on Internet access taxes as established in the Internet Tax Freedom Act of 1998, will expire on October 21, 2001.

Today, we know Internet access generally refers to the \$22.95 (+/-) consumers pay for their monthly access to the "net" through America Online, Mindspring, Microsoft and so on. However, as we witness the convergence of technologies and industry giants, what will Internet access mean in three years, or five years and so on? For example, telephony technology is quickly improving to allow consumers to actually make telephone calls and speak over the Internet. Thus, consumers may soon be able to make long distance or local calls through a function of their Internet service provider at no additional cost, other

than the fee paid for Internet access. You can already download free service from such sites as "dialpad.com," or "Net2phone.com." Current state revenues will decline, as states will be unable to tax these long distance or even local telephone calls. This also would put telephone companies at a competitive disadvantage to Internet service providers.

As the industry mergers continue, consumers may soon be receiving their telephone, cable television and Internet service from the same vendor. The vendor will be able to bundle all these services for one price under the banner of Internet access, likewise for Internet service providers that merge with content providers of music or movies. Under the present definition of Internet access as contained in the Internet Tax Freedom Act of 1998, a permanent moratorium would force states and localities to find new revenue sources to make up for the loss from not being able to tax telephone, cable services and/or downloaded movies, music, books, magazines and so on. Therefore, any extension of the moratorium using the current definition of Internet access must be short term, no more than three to four years with the grandfather clause maintained.

The grandfather clause in the original Internet Tax Freedom Act of 1998 allowed those states presently collecting a tax on Internet access the ability to continue to do so.

Presently, the states of Hawaii, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington and Wisconsin would face a reduction in current revenues if the grandfather clause is repealed. Total loss in 2000 to the listed states would have been over \$ 75 million. This loss combined with future revenue

decreases from the prohibition on Internet access would lead the Congressional Budget Office to score a lengthy or permanent extension of the moratorium as an unfunded federal mandate on state and local governments under the provisions of the Unfunded Mandates Relief Act of 1995.

S. 512– The Internet Tax Moratorium and Equity Act

The National Conference of State Legislatures acknowledges that states need congressional approval for the authority to require remote sellers to collect our states' sales and use taxes, though at the same time, we have serious concerns about congressional interference with state tax policy. **Therefore, we support S. 512, the Internet Tax Moratorium and Equity Act, as introduced by Senators Dorgan, Enzi, and 16 of your colleagues.** I am pleased to testify before this Committee, as five of you are sponsors of this legislation; Senators Graham, Lincoln, Breaux, Rockefeller, and Daschle.

NCSL supports federal legislation that ensures that any sales and use tax simplification process would be developed and implemented on the state and local level and grant to those states the authority to require out of state sellers to collect and remit sales and use taxes. Preservation of state sovereignty is a cornerstone of our federal system; S. 512 as introduced promises an important opportunity to secure our fiscal sovereignty.

With that said, however, I want to make clear that NCSL will oppose any federal mandates that would bring to a halt the simplification process already moving forward in

the states. NCSL will oppose any congressional legislation or amendment that requires one sales tax rate per state for remote commerce, requires states to address non-sales tax telecommunications taxes at the same time that states are simplifying sales tax systems and/or restricts state nexus standards for business activity taxes.

It is our understanding that there are ongoing discussions to try to reach a consensus on a bill that would appear to grant states collection authority but only after the states met a new list of proposed federal mandates. Such new federal mandates as one rate per state, restrictions on state business activity taxes and telecommunications taxes would reduce state revenues substantially more than any offset from uncollected sales and use taxes, thus dooming state simplification efforts.

I would briefly like to discuss the impact of a federal mandate for one rate per state.

One sales and use tax rate per state.

A single rate – even if it only applies to remote sales – is unattainable in a dozen or more states and raises a host of problems.

- First, it preserves a dual system for nexus and non-nexus merchants that will prevent states from simplifying the sales and use tax system for “clicks and mortar” retailers. Sellers with physical stores and remote operations will face two sets of tax rates, frustrating efforts at simplification for all types of retailers. We believe that a

competitive marketplace should decide business decisions and not tax policy. The Streamlined System being developed by the states would create a single system for all retailers. Businesses and technology companies tell us that the rate issue is the easiest one to overcome with technology. It is not necessary to mandate a single rate in a simplified system.

- Second, the dual system will lead to continued litigation over nexus because different rates will be charged based upon the seller’s nexus status. The Streamlined Sales Tax System being developed by the states would make nexus irrelevant and treat all sellers the same.
- Third, we anticipate that some state legislatures could not support a blended rate that would increase tax rates for some taxpayers. The alternative – choosing the lowest rate in the state – could cause powerful cities to oppose such a system. Businesses located in areas with high tax rates that now “self-report” use taxes would have incentives to buy from remote vendors.
- Finally, a federal mandate of one sales tax rate per state would prohibit states from participating where “bond covenants” exist. As I mentioned earlier, a number of state and local governments have issued bonds for the construction of sports stadiums and arenas, land preservation and highway improvements, and have earmarked sales tax revenues to settle the bonds. Thus the sales tax revenues may be under a bond

covenant to pay off a bond, and no action by a state legislature to alter the rate structure would be allowed under those covenants.

For the Committee's information, I would like to list some of the recent activity where bonds were issued for stadiums payable by receipts from the sales tax:

Ballpark at Arlington (MLB), Dallas/Fort Worth, **Texas**, \$ 153 Million in bonds;

BankOne Ballpark (MLB), Phoenix, **Arizona**, \$ 270 Million in bonds;

Raymond James Stadium (NFL), Tampa, **Florida**, \$ 190 Million in bonds;

Paul Brown Stadium (NFL), Cincinnati, **Ohio**, \$ 452 Million in bonds;

Great American Ballpark (MLB), Cincinnati, **Ohio**, \$ 224 Million in bonds;

Coors Field (MLB), Denver, **Colorado**, \$ 161 Million in bonds;

Invesco Field at Mile High (NFL), Denver, **Colorado**, \$ 270 Million in bonds;

Excel Energy Center (NHL), Minneapolis, **Minnesota**, \$ 130 Million in bonds;

Safeco Field (MLB), Seattle, **Washington**, \$ 393 Million in bonds;

New Seahawks stadium (NFL), Seattle, **Washington**, \$ 323 Million in bonds;

New Lambeau Field (NFL), Green Bay, **Wisconsin**, \$ 169 Million in bonds;

Miller Park, (MLB), Milwaukee, **Wisconsin**, \$ 232 Million in bonds;

The National Conference of State Legislatures encourages you and your colleagues to do no harm this year to your state and local governments' efforts to streamline our sales and use tax collection systems. We would urge you to let the states proceed with the next phase of the Streamlined Sales Tax Project as envisioned in S. 512.

Thank you for this opportunity to discuss the state legislative viewpoint on state and local taxation of electronic commerce and telecommunications.