United States General Accounting Office

GAO

Report to Congressional Requesters

June 2000

SALES TAXES

Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain

GAO/GGD/OCE-00-165

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

General Government Division

B-284955

June 30, 2000

The Honorable George V. Voinovich, Chairman
Subcommittee on Oversight of Government Management,
Restructuring, and the District of Columbia
Committee on Governmental Affairs
United States Senate

The Honorable Bob Graham
United States Senate

The rapid growth of electronic commerce (e-commerce), especially the sale of goods and services over the Internet, has fueled a debate about the taxation of such commerce. On the one hand, there are concerns about the impact of e-commerce growth on state and local government sales tax collections. These concerns arise because, while states can impose a tax on residents' purchases from out-of-state vendors, they cannot impose an obligation on those vendors to collect the tax unless the vendor has a substantial presence, or nexus, in the state.[1] Without collection by sellers, and absent intrusive and costly collection actions aimed at purchasers, portions of sales and use taxes can be avoided.[2]

On the other hand, there are concerns that the taxation of Internet sales could slow innovation and growth in the economy. E-commerce and the Internet are viewed as part of a productivity-enhancing "information technology revolution." Taxation of e-commerce, it is feared, could discourage such innovation.

Congress has recognized the need for more information about the implications of taxing e-commerce. For example, in 1998, Congress passed the Internet Tax Freedom Act,[3] which, among other actions, established the Advisory Commission on Electronic Commerce to study the tax treatment of Internet transactions.[4] The act also temporarily banned the

[1]Based on case law, out-of-state remote sellers generally meet the nexus standards if they have an office or place of business, agent, or significant property in the taxing state.

[2]A use tax, generally imposed on the purchaser when a sales tax has not been paid, is imposed on the privilege of ownership, possession, or use of a taxable good or service.

[3]P.L. 105-277, Div. C, Title XI.

[4]The Commission reported in April 2000. The Background section of our report contains more details about the Commission's report.

imposition of certain types of taxes on e-commerce, but not the collection of existing taxes, such as sales and use taxes.

Given your interest in the taxation of e-commerce, and particularly the impact of e-commerce growth on state and local government sales tax collections, you asked us for information specific to sales and use tax collections for Internet sales as well as for all remote sales. In response to your request, this report addresses the following questions:

1. How do the taxes associated with the sale of goods and services over the Internet differ from taxes associated with sales by other remote sellers and in-store sellers?

2. To what extent does each state rely on sales and use tax revenues to fund the services they provide?

3. How much revenue are state and local governments losing this year by not being able to collect sales and use taxes on sales made by all remote sellers and, particularly, by Internet sellers?

4. How much revenue would state and local governments likely lose in 2003 under various growth scenarios for all remote and Internet sales?

In light of the considerable uncertainty surrounding the volume of Internet and all remote sales and any resulting tax losses, we agreed with your office to model different possible scenarios.[5] The scenarios are based on different assumptions about the volume of Internet and remote sales, the proportion of sales that are taxable, the proportion in different taxing jurisdictions, the proportion of taxes actually collected, and other factors that affect tax revenue. We developed lower and higher scenarios to demonstrate an overall range of uncertainty and the potential effects on revenue loss. We also performed a sensitivity analysis to show the revenue loss effects due to uncertainty about specific assumptions. Because of the uncertainty surrounding the assumptions, the scenarios are not estimates but, rather, are illustrations of the importance of the various assumptions. The data and specific assumptions that we used in developing our scenarios are described further in the methodology section of this letter and in appendix I.

[5]Revenue loss is calculated as the amount of tax liability minus the amount already being paid.

Results in Brief

In-store, Internet, and other remote sales are generally taxed at the same rate by a state or local government. However, compliance rates differ significantly depending on nexus. In-store and remote sellers (including Internet sellers) with a substantial presence, or nexus, with the state are legally required to collect and remit the tax. For sales without nexus, purchasers are themselves legally required to remit the tax, but purchaser compliance is generally much lower than seller compliance. The continued growth of e-commerce is likely to magnify existing compliance problems and, as new types of digital goods and transactions are developed, create new ones, such as identifying the location of a sale. Such compliance challenges have led some observers to question the long-term viability of sales and use taxes.

States' reliance on general sales taxes—whether measured as a percentage of tax revenues, own-source revenues, or total general revenues—varies considerably across states.[6] For example, in Delaware, Montana, New Hampshire, and Oregon, neither state nor local governments collect such taxes. In contrast, state governments in Florida, Nevada, South Dakota, Tennessee, Texas, and Washington and local governments in Louisiana obtain over 50 percent of their tax revenues from general sales taxes. In 1999, state and local governments collected $203 billion in general sales tax revenues. On average, general sales taxes account for 33 percent of state and 11 percent of local tax revenues.

Little empirical data exist on the key factors needed to calculate the amount of sales and use tax revenues that state and local governments lose on Internet and other remote sales. What information does exist is often of unknown accuracy. Consequently, we constructed scenarios representing different assumptions about the important determinants of the loss. Under all of our scenarios, the size of the tax loss from Internet sales for 2000 is less than 2 percent of aggregate general sales tax revenues. Under all of our scenarios, the size of the loss from all remote sales is less than 5 percent of aggregate sales tax revenues.

The rapid change in the Internet economy makes projections of revenue losses from Internet and total remote sales for future years even more uncertain than they are for 2000. Under the scenarios we constructed for

[6]General revenues include all revenues except the non-tax revenues generated by government-owned liquor stores or utilities and insurance trust fund revenues (contributions to and investment earnings of public employee retirement and social insurance systems). In addition to tax revenues, own-source general revenues include charges for specific general government services, such as tuition at state universities, and miscellaneous general revenues, such as interest earnings and proceeds from the sale of property. Total general revenues equal own-source revenues plus transfers from other levels of government.

2003, the size of the tax loss from Internet sales ranged from less than 1 percent to about 5 percent of projected sales tax revenues (see p. 21). For all remote sales, the corresponding loss ranged from about 1 percent to about 8 percent.

The results of our scenarios highlight the importance of developing better data about Internet tax losses and understanding the limits of such data. Some of our scenarios show tax losses that by 2003 could present significant revenue challenges for state and local government officials, while other scenarios produce smaller revenue losses. Better data, from efforts such as one by the Bureau of the Census, could reduce the uncertainty. However, even with better data, the rapid and fundamental nature of innovations in e-commerce means that policymaking regarding the tax treatment of Internet sales will be done in an environment of significant uncertainty.

Background

Sales and use taxes are imposed on specific sales transactions. Generally, states require that in-state sellers collect sales tax on the goods and services they sell at the time of sale, based on the price or value of the goods or services sold. States require that out-of-state remote sellers collect a use tax on the sale of goods and services if the sellers have a substantial presence, or nexus, with the state.[7] The use tax, which complements the sales tax, is imposed on the purchaser for the privilege of use, ownership, or possession of taxable goods or services. If the out-of-state remote seller does not collect the use tax, the purchaser is required to remit the tax.

Based on case law interpreting the constitutional requirements, out-of-state remote sellers generally meet the nexus standards if they have an office or place of business, agent, or property in the taxing state. Nexus is not established if the seller's property is insignificant. The Supreme Court has ruled that contact with in-state purchasers by mail or common carrier, only, does not constitute nexus.[8] Although a business can establish dual entity operations to minimize tax liabilities, the extent to which Internet and in-store operations may interact and retain their distinction has not been resolved.

[7]A "remote seller" can be located in the same state as the purchaser; we use the term "out-of-state remote seller" when the remote seller is not located in the same state as the purchaser.

[8]See appendix II for discussion of National Bellas Hess Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967) (addresses Due Process and Commerce Clause nexus standards for mail-order sellers); Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (draws distinction between Due Process Clause and Commerce Clause requirements);and other precedent-setting decisions.

Forty-five states and the District of Columbia have general sales tax programs under which they administer the sales and use tax provisions.[9] About 7,600 local jurisdictions have general sales tax programs authorized by 34 states. Generally, state governments administer the state and local sales taxes.[10]

In 1999, the combined state and local general sales and use tax rates ranged from about 5 to 8 percent in most states. State general sales tax rates were about 4 or 5 percent in most states. Local general sales tax rates varied more and ranged from 0.5 percent to about 4 percent in some jurisdictions.

A number of prior studies have made nationwide estimates of the amount of sales and use tax revenues that state and local governments lose on Internet and other remote sales.[11] The Advisory Commission on Intergovernmental Relations (ACIR) published a series of studies from 1986 through 1994 estimating revenue losses from mail-order sales. ACIR estimated that in 1994, before the recent growth in Internet use, the state and local revenue loss was about $3.3 billion.[12] In more recent years, there have been efforts to estimate the lost tax revenue from Internet sales. A study by Ernst & Young for the eCommerce Coalition[13] concluded that the sales and use taxes not collected from the increase in remote sales due the Internet was less than $170 million in 1998. The authors of that study did not estimate losses on business-to-business Internet sales, but they suggested that these losses would be very small. Researchers, Goolsbee and Zittrain,[14] assumed zero revenue losses from business-to-business Internet sales when they estimated that tax losses from Internet sales in 1998 ranged from $210 million to $430 million and that losses would be about $3.5 billion in 2003.

[9]Alaska, Delaware, Montana, New Hampshire, and Oregon do not have general sales tax programs. Delaware does, however, impose a gross receipts tax.

[10]Local jurisdictions in some states, such as Alabama, Colorado, and Alaska, administer local sales tax programs.

[11]Appendix I identifies specific assumptions and data sources used in these past studies.

[12]U.S. Advisory Commission on Intergovernmental Relations, Taxation of Interstate Mail Order Sales: 1994 Revenue Estimates (1994).

[13]Robert J. Cline and Thomas S. Neubig, The Sky Is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by the Internet in 1998, Ernst & Young, Economics Consulting and Quantitative Analysis (June 18, 1999).

[14]Austan Goolsbee and Jonathan Zittrain, "Evaluating the Costs and Benefits of Taxing Internet Commerce," National Tax Journal, 52(3), Sept. 1999, pp. 413-28.

In contrast, a recent study by researchers, Bruce and Fox,[15] produced much larger revenue loss estimates because the authors assumed that more than half of business-to-business Internet sales are taxable and that compliance on the part of purchasers is well below 100 percent. Bruce and Fox estimated that the revenue loss from Internet sales will grow from $1.23 billion in 1999 to $10.8 billion in 2003. Finally, a study by Forrester Research, Inc.,[16] which focused only on business-to-consumer sales, estimated that sales tax revenue losses from those sales were $525 million in 1999. The authors of most of these studies acknowledged that there is a limited empirical basis for many of the assumptions that need to be made when making such estimates.

The Internet Tax Freedom Act established the Advisory Commission on Electronic Commerce to study "Federal, State and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities."[17] The majority of the Commission issued its report to Congress in April 2000. The Commission voted in favor of a policy proposal relating to state and local government taxation of Internet sales that, among other things, would:

- extend the current moratorium on multiple and discriminatory taxation of e-commerce;
- encourage state and local governments to make their sales and use taxes more uniform;
- prohibit taxation of sales of digitized goods and their nondigitized equivalents; and
- modify the definition of nexus in order to allow out-of-state vendors to conduct additional operations in a state, such as allowing for the return of merchandise or for repairs, without subjecting the vendor to the requirement of remitting sales taxes to the state.

Those voting for the proposal argued that the it would foster innovation and growth of the Internet and e-commerce while recognizing the role of state and local governments to continue providing needed services to their citizens. Those who voted against or abstained were particularly concerned that it would result in large revenue losses for state and local

[15]Donald Bruce and William F. Fox, "E-Commerce in the Context of Declining State Sales Tax Bases," mimeo, University of Tennessee Center for Business and Economic Research (Apr. 2000).

[16]James L. McQuivey, with Gillian DeMoulin, States Lose Half A Billion In Taxes To Web Retail, A Technographics Brief, Forrester (Cambridge, MA, Feb. 24, 2000).

[17]P.L. 105-277, Div C, Title XI, Oct. 21, 1998.

governments, impairing their ability to provide needed services to their citizens. Since these proposals did not receive the two-thirds vote required by the Internet Tax Freedom Act, they were not given the status of formal findings or recommendations of the Commission.

Scope and Methodology

To determine how taxes associated with the sale of goods and services by Internet sellers, other remote sellers, and in-store sellers differ, we reviewed information relating to (1) the federal, state, and local taxes that apply to sales goods and services and to the businesses that sell them and (2) the conditions under which sellers are required to collect state and local sales and use taxes. We reviewed published tax guides, conducted legal research of precedent-setting court cases, and interviewed officials from state tax agencies, the Department of the Treasury, and national organizations representing sellers and state and local governments. We also attended numerous conferences addressing tax issues and the Internet, including the meetings of the Advisory Commission on Electronic Commerce.

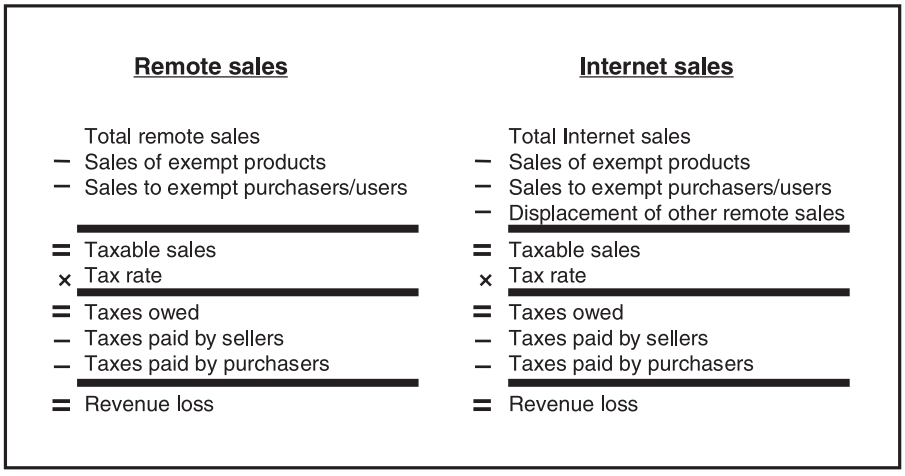
To determine the extent that state and local governments rely on sales and use tax revenues, we analyzed data from the Census Bureau relating to U.S. totals for those revenues in calendar year 1999. We also analyzed Census data on state government revenues for fiscal year 1998 and local government revenues for fiscal year 1996, the latest years for which state-by-state data were available.

To model different scenarios for the state and local government sales and use tax revenue losses, we obtained estimates of the total amount of sales that will be transacted remotely in 2000 and subjected them to a series of computations that reflect (1) details of state sales tax systems and (2) assumptions relating to the various factors that determine the size of the revenue losses. In addition to the revenue loss associated with all remote sales, we modeled different scenarios for the loss that was attributable to Internet sales alone. Figure 1 summarizes the steps in our revenue loss computations.

To approximate the amount of remote sales that will be taxable, we apportioned the sales data among individual states and then subtracted state-specific exemptions for particular types of products, services, purchasers, and uses. We then multiplied the taxable sales in each state by the appropriate tax rate to obtain an approximation of the sales or use tax owed to each state. To compute the amount of revenue that each state government is unable to collect, we made assumptions regarding the amount of the tax owed on remote sales that would be paid to each state

by either sellers or purchasers. We then subtracted that amount from the amount owed to the state to obtain the state-level revenue loss.

Figure 1: Steps Involved in Computing Revenue Losses



Source: GAO methodology.

We report high and low estimates for all remote and Internet only sales for the years 2000 and 2003. To calculate the potential sales and use tax losses for the higher scenario, we use the endpoint of the range for each of our assumptions that leads to a higher revenue loss. For example, we use the high estimate of sales, a low estimate of nexus for sellers, a low rate of purchaser compliance, and a low rate of product and purchaser exemptions. We use the other endpoints of our estimated ranges to calculate the sales tax losses for our low tax loss scenario. Combining assumptions in this way increases the likelihood that the actual tax losses fall between the high tax and low tax scenario results.

We obtained the local government revenue loss in each state by multiplying the state government loss by the ratio of local sales tax collections to state sales tax collections in each state.[18] We also modeled the amounts of revenue that state and local governments would potentially lose on Internet and other remote sales in 2003 under alternative scenarios for the growth of those sales.

There were few reliable data sources on which to base the calculations and adjustments summarized above. The growth of on-line sales has been

[18]In the case of Alaska, where local governments collect general sales taxes but the state government does not, we assumed that the state's share of the nationwide local government revenue loss was proportionate to its share of nationwide local government sales tax collections.

so rapid that the economic data available from federal and state governments have not been modified to provide this kind of information, and those that are collected are not well suited for this purpose. Most of the sales estimates that are available are from private-sector sources, and some of these providers view their data sources and details as proprietary. Finally, projections of sales are particularly difficult to make given the rapidly changing environment and the importance of decisions yet to be made by consumers, businesses, and policymakers that will determine the ultimate level of those sales. We were not able to assess the accuracy of any of the available estimates and projections of sales.

In addition to the uncertainty regarding the magnitude of remote sales, there is considerable uncertainty about the amount of tax that state and local governments are already collecting from these remote sales and the extent to which Internet sales replace other forms of remote sales. Little empirical data exist to reduce these uncertainties. To ensure that we did not overlook any important data, we reviewed the existing literature and spoke with numerous experts in academia, the private sector, and in government, including officials from 17 states.[19] In certain cases, we collected our own data on important parameters where we believed we had an opportunity to improve upon the information that prior analysts had used. For example, we gathered information from 150 large remote retailers regarding the specific states for which they were already collecting sales taxes. We also used Department of Commerce data as a basis for our assumptions relating to the proportions of business-to-business remote sales that are sold to various types of tax-exempt purchasers. We also performed a sensitivity analysis to show the revenue loss effects due to uncertainty about specific assumptions.

We also subjected our work to peer review by noted experts in the field of tax policy. These experts agreed with the general approach that we followed in making our estimates, but they provided different estimates about specific factors that determine the size of the revenue loss, such as the extent to which purchasers are currently complying with their use tax obligations. The experts confirmed that uncertainty surrounds many of these factors incorporated into the model. Our approach reflects their suggestions and comments, particularly the use of ranges of estimates for key determinants of the revenue loss.

[19]We selected the states to contact on the basis of referrals from national organizations, including the Multistate Tax Commission and the Federation of Tax Administrators, which indicated that these states were conducting studies on the issue of remote sales or had cutting-edge compliance programs.

The definition of revenue loss that we use in our scenarios is the amount of sales or use tax owed on remote sales, minus any amount already being paid by sellers or purchasers. There are two reasons why this amount is likely to be higher than the amount that state and local governments would receive if all remote retailers were required to collect and remit taxes on their sales. First, even if all remote sellers were required to collect the taxes due on their sales, compliance is not likely to be 100 percent. Second, the total volume of taxable sales may decline in response to a higher rate of tax collection on these sales. In computing the revenue loss attributable solely to the advent of Internet sales, we excluded losses associated with the portion of Internet sales that would have been transacted by other remote means, such as mail order, in the absence of the Internet.

Detailed information about our methodology, including the data sources that we used, are provided in appendix I. We conducted our work from June 1999 to May 2000 in accordance with generally accepted government auditing standards.

Tax Liabilities for Internet and Other Sales Are Generally the Same, but Compliance Can Differ

For a particular good or service and taxing jurisdiction, remote sales, Internet sales, and in-store sales are generally subject to the same rate of sales or use tax. However, tax compliance differs by type of sale, with nexus being an important influence. For example, remote sellers with nexus are required to collect the tax but sellers without nexus are not. E-commerce presents compliance challenges for sales and use tax administration beyond those created by other remote sales.

Tax Liabilities for Internet, Other Remote, and In-store Sales Are Generally the Same

After reviewing published information and talking to state tax officials, officials from several national organizations representing state governments, and private-sector representatives, we were unable to identify significant differences in the tax rates on in-store sales, Internet sales, and other remote sales. Although states vary in which goods and services they tax and in their tax rates for a given good or service in a particular location, the rate does not depend on whether the sale is in-store, Internet, or other remote.[20]

[20]We asked officials from state revenue departments and national associations, such as the Multistate Tax Commission, National Governors' Association, and National Retail Federation, to identify specific examples of different tax requirements for in-store and out-of-state remote sales. None identified any significant different sales, excise, or income tax requirements, but several referred to Connecticut's tax on the on-line sale of a newspaper that purchasers could buy untaxed at the newsstand. A Connecticut official advised that the state taxes paid-for digital services that include newspapers sold on-line. Connecticut expects to phase out its on-line newspaper tax by 2002.

The type of goods and services included in the sales and use tax base vary by taxing jurisdiction. In states with sales and use taxes, retail goods are taxed unless exempted. The list of exempt goods varies by state. For example, most but not all states exempt groceries. Unlike goods, services are generally untaxed, although there are exceptions. Tables III.1 and III.2 in appendix III provide more detailed information about the tax treatment of goods and services by state.

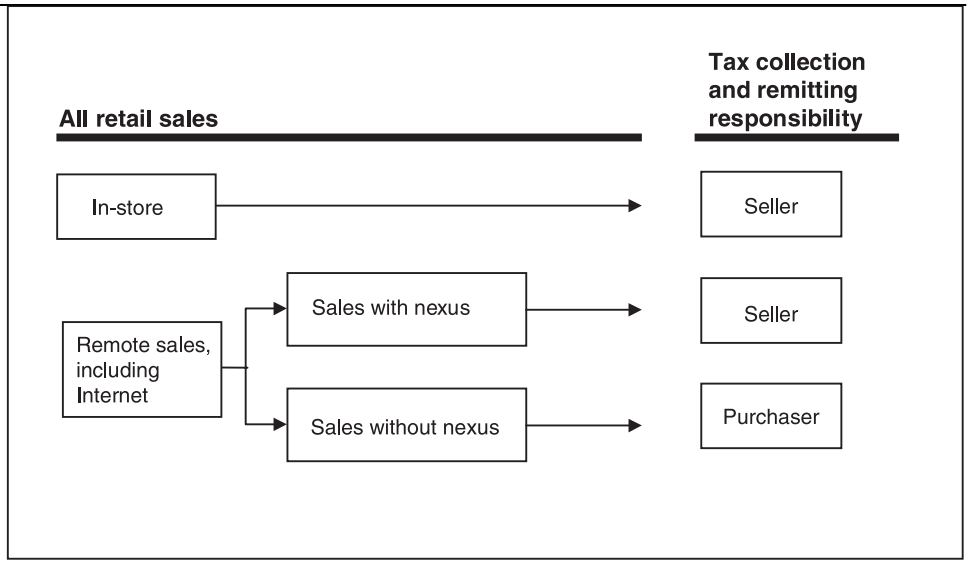
Sales and use tax rates also vary by taxing jurisdiction. Five states do not impose a state-level general sales or use tax. The 1999 combined state, county, and city tax rates for selected jurisdictions ranged from 4 to 9 percent. Table III.3 in appendix III provides more details on 1999 general sales tax rates for each state and selected local jurisdictions.

Collection Responsibilities for Remote Retailers Depend Upon Nexus

Whether a remote retailer is legally required to collect a sales tax depends on whether the retailer has substantial presence or nexus with the taxing jurisdiction. As defined by case law, remote sellers generally meet the nexus standard if they have an office or other place of business, property, or agent in the taxing state. Remote sellers, including Internet sellers, that have nexus with a taxing state are responsible for collecting the use tax from purchasers at the time of sale and remitting the tax to the taxing jurisdiction. Remote sellers with nexus have the same tax collection responsibilities as an in-store seller. Figure 2 summarizes tax collection and remittance responsibilities for in-store, Internet, and other remote sellers.

Court decisions interpreting the provisions of the Commerce and Due Process Clauses of the Constitution preclude the states from requiring a remote seller without nexus to collect the use tax. If the remote seller does not collect a use tax, then the purchaser is responsible for paying the tax to the taxing state where they use, consume, or store the purchased goods or service. Appendix II contains a more detailed discussion of the constitutional restrictions on state authority to require a remote retailer to collect the use tax.

Figure 2: Responsibility for Sales and Use Tax Collection and Remittance



Source: GAO analysis.

Sales and Use Tax Compliance Differs by Type of Sale

While reliable national estimates of sales and use tax compliance do not exist, state officials and other observers believe that compliance is highest for in-store sales, next highest for remote sales with nexus, and lowest for remote sales without nexus.[21] Their belief rests on three facts. First, in-store sellers are more visible to the states than remote sellers, leaving the states better positioned to enforce compliance through audits and other actions. Second, the states have legal authority to enforce sales and use tax collection by in-store sellers and remote sellers with nexus. Third, because of enforcement costs, the states generally rely on purchasers to voluntarily comply with the use tax when there is no nexus. The differences in compliance thus depend on whether the sale is in-store or remote and, for remote sales, on whether the remote seller has nexus.

Electronic Commerce Presents Challenges for Sales and Use Tax Systems

Electronic commerce and the related changes in technology present challenges for the administration of sales and use taxes. One challenge is presented by continued growth in the volume of Internet sales. To the extent that such growth occurs, it increases remote sales where compliance is already most problematic. Another challenge is that the expanding variety of e-commerce transactions and products may create new types of compliance problems, such as identifying the location and

[21]Available evidence suggests that compliance among businesses is also highest for in-store sales and lowest for remote sales without nexus. However, the rate of business purchaser compliance for remote sales without nexus is believed to be considerably higher than consumer purchaser compliance.

nature of a sale. Such challenges have led some observers to question the long-term viability of the sales and use tax system.

Although the future growth rate of Internet sales is not known, certain characteristics favor the rapid growth of Internet sales. For example, Commerce has reported that e-commerce not only reduces the cost and time of doing business but also provides alternative shopping sites, expands existing markets, and creates new markets. E-commerce also frees some sellers from the "geographic confines and the costs of running actual stores." These characteristics have the potential to increase the number of remote sellers and purchasers as well as increase the volume of remote sales. To the extent that such sales growth occurs, it will magnify the existing sales and use tax compliance problems associated with remote sales, such as the difficulty of enforcing compliance by purchasers in the case of remote sales without nexus.

The expanding variety of electronic transactions may also create new compliance challenges. Shifts from traditional forms of sales to Internet sales can make it more difficult to identify the location of the buyer and the seller, the status (business, individual, other) of the buyer or seller, and the nature of the product itself. In terms of the location, both sellers and purchasers may have multiple locations, and the Internet makes it easier for these firms to conduct their transactions from the location that offers the greatest tax advantages. Businesses may also choose to establish a presence in certain jurisdictions in order to maximize these advantages. As a result, determining the location of buyers and the sellers' activities for nexus purposes, which is important for the collection of sales and use taxes, is more difficult in an environment with Internet sales.

A related challenge for the collection of sales and use taxes is determining the status of the buyer and seller in Internet transactions. The status of the seller, for example, is relevant since certain sales by individuals are not subject to sales and use taxes. However, the development of new markets, such as Internet auctions, has created a new opportunity for businesses as well as individuals to avoid sales and use taxes. To the extent that businesses are using these new markets to make sales, it would be necessary for tax authorities to be able to identify those sellers as businesses rather than as individuals in order to assess the appropriate taxes.

The increasing variety of digital products also creates challenges for sales and use taxes. Currently, purchasers can buy many digital products, such as books, music, software, and videos, that were only available as tangible

products a few years ago. The sale of digital products often makes it more difficult for states to determine if there was a sale, the point of sale, and the cost or value of the products sold. Further complicating state tax requirements and compliance efforts is the taxability of digital products and services, which can be questionable. Case law defining the conditions that must exist before a state can require a remote seller to collect a use tax refers to the taxed goods as "tangible personal property." States may not be able to require the remote sellers to collect the use tax on the sale of intangible digital products unless they categorize these products as intangible services.

General Sales Taxes Account for 33 Percent of State Government and 12 Percent of Local Government Tax Revenues

On average, general sales taxes account for 33 percent of the state government tax revenue and 11 percent of local government tax revenue. However, reliance on general sales taxes varies considerably across states. Table 1 shows the reliance of state and local governments on sales taxes whether measured as a percentage of tax revenues, own-source revenues, or total general revenues.

Table 1: State and Local Government Reliance on General Sales Taxes

General sales tax revenue as a percentage of:	State		Local	
	Percent	Year[a]	Percent	Year[a]
Total tax revenue	33	1999	11	1999
Total general own-source revenue	25	1998	7	1996
Total general revenue	18	1998	4	1996

[a]Most recent year that data were available.

Source: GAO analysis based on Bureau of the Census data.

Overall, state and local governments collected $203 billion in general sales and use taxes in 1999. In 34 states, both state and local governments collect at least some revenue from general sales taxes; while in Delaware, New Hampshire, Montana, and Oregon, neither level of government collects general sales tax revenue. In the remaining 12 states, only one level of government collects a general sales tax.

Tennessee, Florida, and Nevada are the three state governments that rely most heavily on general sales tax revenues, whether measured as a share of tax revenues, own-source revenues, or all general revenues.[22] Each of

[22]The Census general sales tax figures for Washington State and Indiana include, respectively, $1,854 million and $548 million from gross receipt taxes that are closer to business taxes than they are to general sales taxes. If those revenues are disregarded, Washington State is not one of the top three states in terms of reliance on general sales taxes. There are additional reasons why the Census data for general sales tax revenues are not strictly comparable across states (see Due and Mikesell, 1994). For example, certain products and services in some states are not subject to the general sales tax;

these states obtains at least 53 percent of their tax revenues, 44 percent of their own-source general revenues, and 28 percent of all their general government revenues from general sales taxes. Local governments in Louisiana, Oklahoma, and Alabama rely on general sales taxes for greater shares of their tax revenues (at least 40 percent each) and own-source revenues (at least 19 percent each) than do local governments in other states. Local governments in Louisiana, Oklahoma and Colorado rely on general sales taxes for the greatest shares of total general revenues (at least 12 percent each). (See app. IV for state and local revenue information.)

State and Local Revenue Losses From Internet and Other Remote Sales Are Small Under Most Scenarios for 2000

The amount of sales and use tax revenues that state and local governments may lose by not being able to collect those taxes on Internet and other remote sales is difficult to model because considerable uncertainty surrounds the factors that determine the loss. However, under our scenarios representing different assumptions about the important determinants of the loss, the size of the loss from Internet sales for 2000 is less than 2 percent of aggregate sales and use tax revenues. The size of the loss from all remote sales is less than 5 percent of aggregate sales and use tax revenues.

Considerable Uncertainty Surrounds the Determinants of State and Local Revenue Losses

Important factors that determine the tax loss on Internet and remote sales are the volume of Internet and other remote sales, the portion of the sales subject to tax, the extent of compliance by sellers or purchasers, and the extent to which Internet sales displace other types of remote sales. However, as discussed below, little data exist on these factors and the accuracy of the information that exists is often unknown.

The Volume of Remote Sales

No statistical agency compiles data on the total value or composition of Internet or other remote sales. Although the Census Bureau has collected data on mail-order sales, their figures do not include the mail-order sales of any firms whose primary business is not mail order. As a result, their figures significantly understate total mail-order sales. The Bureau has plans to produce comprehensive data on Internet sales based on its annual surveys of firms in the manufacturing, wholesale, retail, and other sectors, but much of these data will not be available until 2001. A number of private-sector consulting firms make estimates and projections of Internet and other remote sales. It is difficult to assess the accuracy of any of their estimates. Given the uncertainty surrounding available projections of total remote and Internet sales for 2000 and 2003, we use a broad range of

however, they are subject to equivalent special sales taxes. Those special taxes are not included in the Census general sales tax figures, but they are covered in our revenue loss computations.

projections in the scenarios that we present below. Appendix 1 describes the projections that we use.

The Taxability of Remote Sales

The rate at which a remote sale is taxed can vary depending on the state of residence of the purchaser, the nature of the product or service being sold, the nature of the purchaser, and the use that the purchaser makes of the product or service. For example, a computer purchased by a state agency or by a business that uses it in a manufacturing process may not be taxed in a particular state, even though a computer purchased by a law firm in that same state would be taxed.[23] We were able to obtain some estimates of Internet and total remote sales that were disaggregated by broad categories of purchasers (businesses versus individuals) and by broad categories of products and services, but we could not determine the accuracy of these estimated disaggregations. We were unable to identify any estimates of sales by taxable versus tax-exempt purchaser or by taxable versus tax-exempt use.

The Extent to Which Remote Sellers Already Collect Tax

When remote sellers have nexus in states in which they make sales, they are required to collect any sales taxes that apply to those sales. In addition, some remote sellers collect taxes voluntarily, even when they do not have nexus. The proportion of tax already being collected by sellers (which we call the "seller collection rate") varies by type of product. For example, a very high proportion of the taxes due on cable television services and utilities are likely to be collected because a large proportion of those services are provided by businesses with in-state physical infrastructure. In contrast, a relatively low proportion of the taxes due on remote sales of computers are likely to be collected from sellers because a large proportion of these sales are made by sellers who have nexus in only a few states.

As a result of this variation across products and services, the overall seller collection rate will change over time as the composition of remote sales changes. The collection rate within particular product categories will also change as the market shares, physical locations, and organizational form of particular businesses change. Such change is particularly rapid in the Internet economy. Policy changes that affect the determination of nexus could also have substantial impacts on seller collection rates.

[23]The success that a state has in collecting the tax due on a sale also can vary by type of purchaser. Business purchasers are more likely than individual purchasers to comply with their use tax obligations because they face a much higher probability of being audited by state tax agencies.

We found two studies containing empirical estimates of the seller collection rate, but they were either dated or limited in scope. Other analysts who have estimated the revenue losses associated with Internet and other remote sales have used a variety of assumptions regarding the proportion of tax already being paid. We based our own assumptions on information we obtained from businesses that account for large proportions of Internet and other remote sales as well as on discussions with state tax officials (see app. I).

The Extent to Which Purchasers Already Pay Tax

No comprehensive data are available relating to the rate of use tax compliance on the part of purchasers. Only 2 of the 17 states we contacted provided empirically based estimates of use tax compliance on the part of business purchasers, and those estimates date from the early 1990s—before the widespread use of the Internet. The two states, Washington and Wisconsin, used the results of state use tax audits to estimate that approximately 80 percent of the use tax owed by business purchasers in their states was paid voluntarily. An official from the Michigan Department of Treasury believed that nearly all businesses in the state comply with the use tax because it is covered in single business tax audits. That official noted that compliance rates are likely to vary from state to state, depending on enforcement efforts. An official from Connecticut's Department of Revenue Services believed that businesses pay about 65 percent of their use tax liabilities, while an official from Ohio's Department of Taxation believed that businesses' rate of compliance is 75 percent. Other states were unable to provide estimates but some experts believe the rate could be as low as 50 percent for non-motor-vehicle purchases.[24] Our scenarios reflect the broad range of opinions that state officials and other analysts have regarding this compliance rate.

In contrast to the wide range of opinion on the compliance of business purchasers was a wide consensus among the state officials and other experts who provided estimates that use tax compliance by individual purchasers was extremely low—on the order of 0 to 5 percent. However, there was also a wide consensus that compliance with the use tax on motor vehicles is close to 100 percent because the taxes must be paid before those vehicles can be registered.

The Extent to Which Internet Sales Displace Other Types of Sales

A portion of total Internet sales displaces sales that would have been transacted in stores; another portion displaces sales that would have been transacted through other remote channels, such as mail orders; and a final portion represents sales that would not have occurred in the absence of

[24]Some authors noted that use tax compliance was low even before the advent of e-commerce.

the Internet. In the results that we present below, we exclude the revenue losses on Internet sales that displace other remote sales. We found no empirical evidence indicating what proportion of Internet sales replace other forms of remote sales. Few researchers or other experts that we contacted offered estimates of this proportion, and none of those were empirically based. Given this high degree of uncertainty, we use a broad range of assumptions in our scenarios.

The distinction between Internet and other remote sales has become less meaningful as more businesses offer both Internet and other remote transaction options. Some purchasers may order and pay for products by mail after obtaining the necessary information over the Internet; other purchasers may place orders over the Internet after obtaining information from a mail-order catalogue. The tax treatment of the product purchased does not differ between orders placed by mail and orders placed over the Internet.

Under Our Scenarios, the Current Loss on All Remote Sales Is Less Than 5 Percent of Sales Tax Revenue and the Loss on Internet Sales Is Less Than 2 Percent

We developed two basic scenarios to illustrate the uncertainty surrounding the revenue loss on Internet and other remote sales in 2000. Each scenario consists of a set of assumptions about the factors that determine the size of that loss. We identified a range of plausible assumptions for each factor, based on available data, estimates, and expert opinion. In our lower scenario, the assumptions that we selected for each factor were those that tended to reduce the revenue loss. In our higher scenario, we used assumptions that tended to increase the revenue loss.[25] However, although the results from our higher scenario are based on a combination of assumptions that tend to increase the revenue loss, we cannot be certain that those results represent an upper bound to the revenue loss. We also examined how the results of each scenario changed when individual assumptions were altered. Table 2 presents the results of the two scenarios.[26]

The assumptions used in the lower scenario result in a revenue loss on all remote sales of $1.6 billion. The loss attributable to Internet sales that did not simply replace other remote sales is $0.3 billion. In contrast, the assumptions used in the higher scenario yield a revenue loss of $9.1 billion on all remote sales—less than 5 percent of state and local general sales tax revenues.[27] The loss attributable to Internet sales is $3.8 billion—less than

[25]The assumptions that we used for each scenario are provided in appendix I.

[26]Appendix V provides results for each state.

[27]These percentages were computed using the assumption that the annual rate of growth in collections from 1999 to 2003 would be the same as the annual rate of growth from 1990 through 1999.

2 percent of revenues. The revenue losses associated with business-to-business sales vary more widely across scenarios than do the losses associated with business-to-consumer sales for several reasons. First, there is a greater variance across scenarios in the underlying business-to-business sales estimates. Second, we used a wider range of assumptions regarding the proportion of business-to-business sales that are taxable. Finally, we used a wider range of assumptions for the business purchaser compliance rate.

Table 2: State and Local Sales Tax Losses for All Remote Sales and Internet Sales Only in 2000

Dollars in billions

Revenue losses	Lower scenario	Higher scenario
All remote sales		
Business-to-consumer	$1.5	$4.2
Business-to-business	0.1	4.9
Total	**$1.6**	**$9.1**
Internet sales		
Business-to-consumer	$0.2	$0.8
Business-to-business	[a]	2.9
Total	**$0.3**	**$3.8**

Note: Columns may not add due to rounding.

[a]An amount less than $50 million.

Source: GAO analysis.

Table 3 shows how sensitive our higher scenario results are to changes in important assumptions.

Table 3: Sensitivity of Higher Scenario Revenue Losses in 2000 to Changes in Key Assumptions

Dollars in billions

Revenue losses	Higher scenario from table 2	Using lower sales estimates	Using higher business purchaser compliance rate	Using higher displacement rate
All remote sales				
Business-to-consumer	$4.2	$2.8	$2.8	No change
Business-to-business	4.9	3.3	0.3	No change
Total	**$9.1**	**$6.1**	**$3.1**	**No change**
Internet sales				
Business-to-consumer	$0.8	$0.5	$0.3	$0.6
Business-to-business	2.9	2.0	0.2	1.0
Total	**$3.8**	**$2.5**	**$0.5**	**$1.5**

Note: Columns may not add due to rounding.

Source: GAO analysis.

As expected, the underlying sales estimates that we use have a great influence on the revenue loss. For example, if we kept all of the assumptions for our higher scenario unchanged, except for switching to

the lower sales estimates, the revenue loss on all remote sales for 2000 would fall from $9.1 billion to $6.1 billion. However, even for a given sales figure, we obtained a considerable range of revenue estimates by varying assumptions for other factors. For example, if we changed the assumed rate of business purchaser compliance in the higher scenario from 50 percent to 95 percent and left everything else the same, the revenue loss on all remote sales would fall to $3.1 billion.

The assumptions that we made about the proportion of Internet sales that displace other remote sales do not affect the revenue loss on all remote sales; however, they do have a significant effect on the loss attributed to Internet sales. For example, if we kept all of the assumptions for our higher scenario unchanged, except for changing the displacement proportion from 25 percent to 50 percent for sales to consumers and from 40 percent to 80 percent for sales to businesses, the revenue loss on Internet sales would fall from $3.8 billion to $1.5 billion. Appendix I presents variations of our two basic scenarios that show the sensitivity of our results to other changes in assumptions.

Each state's share of the revenue loss is primarily a function of its share of total sales, the scope of its sales tax exemptions, its rate of tax, and the extent to which remote sellers have a substantial connection with it. State-by-state revenue losses under our two scenarios are presented in appendix V. These state-by-state results are more sensitive than our national results are to some of our assumptions (e.g., how aggregate sales are distributed across states).

The Size of Future State and Local Revenue Losses Is Very Uncertain

We developed lower and higher revenue loss scenarios for 2003 that are the same as the scenarios presented above, except for the underlying sales projections (which are described in app. I). The rapid change in the Internet economy makes projections of Internet and total remote sales for future years considerably more uncertain than they are for 2000. The rate of growth and fundamental changes in the patterns of buying and selling from one year to the next suggest that historical information is not particularly useful in making estimates of future growth. Table 4 presents the results of the two scenarios for 2003. The assumptions used in the lower scenario result in a revenue loss on all remote sales of $2.5 billion—equivalent to about 1 percent of projected general sales tax revenues. The loss attributable to Internet sales that did not simply replace other remote sales is $1.0 billion—less than 1 percent of projected general sales tax revenues. In contrast, the assumptions used in the higher scenario yield a revenue loss of $20.4 billion on all remote sales—about 8 percent of

projected revenues. The loss attributable to Internet sales is $12.4 billion—about 5 percent of projected revenues.

Table 4: State and Local Sales Tax Losses for All Remote Sales and Internet Sales Only in 2003

Dollars in billions

Revenue losses	Lower scenario	Higher scenario
All remote sales		
Business-to-consumer	$2.1	$5.9
Business-to-business	0.4	14.5
Total	**$2.5**	**$20.4**
Internet sales		
Business-to-consumer	$0.9	$3.7
Business-to-business	0.1	8.7
Total	**$1.0**	**$12.4**

Note: Columns may not add due to rounding.

Source: GAO analysis.

The choice of sales estimates that one uses and the choice of purchaser compliance rates on sales to businesses have particularly large effects on the results (see table 5). If we kept all of the assumptions for our higher scenario unchanged, except for switching to the lower sales estimates, the revenue loss on all remote sales would fall from $20.4 billion to $13.6 billion. If we changed the assumed rate of business purchaser compliance in the higher scenario from 50 percent to 95 percent and left everything else the same, the revenue loss on all remote sales would fall to $4.9 billion.

Table 5: Sensitivity of Higher Scenario Revenue Losses in 2003 to Changes in Key Assumptions

Dollars in billions

Revenue losses	Higher scenario from table 4	Using lower sales estimates	Using higher business purchaser compliance rate	Using higher displacement rate
All remote sales				
Business-to-consumer	$5.9	$3.9	$3.9	No change
Business-to-business	14.5	9.7	1.0	No change
Total	**$20.4**	**$13.6**	**$4.9**	**No change**
Internet sales				
Business-to-consumer	$3.7	$2.0	$2.0	$2.5
Business-to-business	8.7	5.8	0.6	2.9
Total	**$12.4**	**$7.8**	**$2.6**	**$5.4**

Note: Columns may not add due to rounding.

Source: GAO analysis.

Concluding Observations

There are three themes that run through this report. One is that under most of our scenarios, the tax loss associated with Internet sales is small for 2000, but under some scenarios, could be much larger by 2003. Another is that continued growth in Internet sales is likely to present major compliance challenges for sales and use tax administrators—to the extent that some have questioned the long-term viability of such taxes. Finally, there is tremendous uncertainty about all of the major determinants of the tax loss.

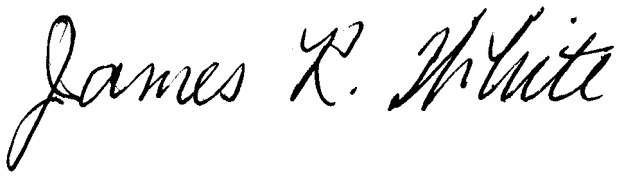
When combined, these three themes highlight the importance of efforts to get better data about the determinants of the tax loss, such as the Census Bureau's program to measure Internet sales. Current economic data are not well suited to tracking rapidly evolving Internet activity. With better data, policymakers would be better positioned to confront the challenges presented by e-commerce to sales and use tax administration. One benefit of such data would be more accurate estimates of sales and use tax losses to state and local governments. Perhaps more importantly, such data could provide more of a basis for evaluating alternative policy choices.

Understanding the limits of data, however, in an environment as dynamic as the Internet is important. Innovations in Internet sales—with new types of goods, services, and transactions—are rapid and unpredictable. Further, many of the key decisions by consumers, businesses, and policymakers that will determine the extent of Internet tax losses in the near future have not yet been made and will not be reflected in data that are necessarily historical. As a consequence, even with improved data, policymaking regarding Internet sales will be done in an environment of significant uncertainty.

As agreed, unless you announce the contents of this report earlier, we plan no further distribution until 14 days from the date of this letter. At that time, we will send copies of this report to Senator Richard J. Durbin, Ranking Minority Member of the Subcommittee; the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable William M. Daley, Secretary of Commerce; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue and other interested congressional parties. We will also make copies available to others on request.

Please contact me or James A. Wozny at (202) 512-9110 if you have any questions. Key contributors to this report are acknowledged in appendix VII.

Sincerely yours,



James R. White
Director, Tax Policy
and Administration Issues

Contents

Tables

Figures

Methodology for the Revenue Loss Scenarios

This appendix provides further details on the methodology we used to compute the various revenue loss scenarios presented in the letter in tables 2 through 5. It also provides additional analyses of the sensitivity of our results to changes in specific assumptions.

The Volume and Composition of Internet and Other Remote Sales

To obtain sales estimates, we reviewed academic, government, and private-sector studies, including those published on the Internet. We also contacted the authors and other experts in this field to identify other potential sources of sales estimates. There were many estimates available for business-to-consumer Internet sales but only a limited number for business-to-business Internet sales and all remote sales. We were not able to assess the accuracy of any of the available estimates. However, given the difficulty of making such estimates, particularly for future years, we believe that they all have substantial margins of error. In our revenue loss scenarios, we try to represent the broad range of estimates for business-to-consumer Internet sales that have been made for 2000 and 2003. For other categories of sales, where we had to rely on a single source of estimates, we applied a margin of error of 20 percent to acknowledge the fact that there is considerable uncertainty around the estimates.

Business-to-Consumer Internet Sales

For business-to-consumer Internet sales, the range of estimates that we identified is similar to the list reported in eMarketer's "The eCommerce: B2C Report," April 2000.[1] We chose our range of estimates from a subset of sources (all private research firms) that used the same definition of Internet sales—transactions placed and paid for over the Internet. From among that group, Forrester Research, Inc., represented the higher end of the range, with sales estimates of $39 billion for 2000 and $143 billion for 2003.[2] Jupiter Communications represented the lower end of the range, with sales estimates of $23 billion for 2000 and $78 billion for 2003. Both Forrester and Jupiter base their estimates on surveys of consumers and surveys and interviews of businesses. Bruce and Fox, and Goolsbee and Zittrain both used business-to-consumer sales estimates by Forrester in their studies. Cline and Neubig used a sales estimate that they said was on the high end of available estimates at the time of their analysis. When making its own state revenue loss estimate, Forrester relied on two

[1]"The eCommerce: B2C Report," eMarketer (New York, Apr. 2000), p. 30.

[2]The business-to-consumer sales estimate for 2000 contained in the April 2000 shop.org/Boston Consulting Group study was higher than the Forrester estimate, but after removing non-U.S. sales, financial services, and nonsales revenues contained in the Boston Consulting Group estimate, the Forrester estimate was higher.

surveys of consumers, one of which asked buyers how often they paid taxes when shopping on-line.[3]

Business-to-Business Internet Sales

Forrester Research's estimates of business-to-business Internet sales are the only ones that we found that were made within the last year.[4] We used Forrester's estimates with a 20-percent margin of error for our scenarios, giving us lower end estimates of $325 billion for 2000 and $1,459 billion for 2003, and higher bound estimates of $487 billion for 2000 and $2,188 billion for 2003. Forrester made separate estimates of business-to-business sales for service industries, which we also incorporated into our scenarios with 20-percent error bounds. The lower sales estimates for these services are $35 billion for 2000 and $176 billion for 2003. The higher estimates are $52 billion for 2000 and $264 billion for 2003. In their study, Bruce and Fox used an earlier set of Forrester business-to-business sales estimates.

Total Business-to-Consumer Remote Sales

We decided that the best available estimates of total remote business-to-consumer sales for our analysis were those produced by Marketing Logistics Inc., a research firm that has produced such estimates for 18 years.[5] Its estimates are disaggregated by detailed product and service categories.

Marketing Logistics measures orders that are placed by mail, phone, or electronically and that do not require the purchaser to visit the seller's premises, or vice versa. Its estimates are based on "micro" and "macro" techniques. The micro technique involves identifying the mail order businesses in an industry and estimating the remote sales for each business. Marketing Logistics has a proprietary database that contains information on over 10,000 companies. The macro technique uses estimates of aggregate remote sales for certain sales segments. The Advisory Commission on Intergovernmental Relations (ACIR) used the Marketing Logistics data as the basis for making its past estimates of revenue losses on remote sales.

[3]Forrester's general approach differed from those of the other prior studies (which were broadly similar to our approach). Among the significant differences are that Forrester did not attempt to distinguish between taxable and nontaxable sales (except for travel) and did not make an adjustment for Internet sales that displace other remote sales.

[4]Forrester's primary report on business-to-business Internet sales, "eMarketplaces Boost B2B Trade," is dates February 2000; its separate report on business-to-business services, "Business Services On the Net," is dated January 1999. Forrester based both of these studies on interviews with officials from large firms. For the first study, it also relied on discussions with industry experts, strategy consultants, technology vendors, and eMarketplaces.

[5]Direct Marketing Association estimates a category of sale—"direct order sales"—that is roughly equivalent to total remote sales; however, we believe the estimating techniques and the amount of detail were preferable in the Marketing Logistics data.

After applying a 20-percent margin of error to the Marketing Logistics estimates, the higher and lower estimates that we used for business-to-consumer sales in 2000 were $278 billion and $186 billion. The higher and lower estimates for 2003 were $391 and $261 billion.

Total Business-to-Business Remote Sales

Marketing Logistics' estimates of total business-to-consumer remote sales were significantly higher than the highest estimates that we used for business-to-consumer Internet sales. However, its estimates of total business-to-business remote sales were much lower than the Forrester estimates of business-to-business Internet sales (even after we reduced the latter by 20 percent). We decided to use the adjusted Forrester estimates as the estimates for both Internet business-to-business sales and total business-to-business remote sales because the Forrester estimates were considerably more recent than the Marketing Logistics estimates and because the e-commerce environment is changing so rapidly. This decision prevents a logical inconsistency between the Internet and the total remote sales estimates that we use. However, the fact that the inconsistency exists between the original estimates is further evidence that these estimates should be used with caution.

Table I.1 summarizes the choices we made among sources of estimates for each major category of sales.

Table I.1: Choices of Sales Estimates Used in the Scenarios

Sales	Business-to-consumer	Business-to-business
Internet		
High end	Forrester	Forrester x 120 percent
Low end	Jupiter	Forrester x 80 percent
All remote		
High end	Marketing Logistics x 120 percent	Forrester[a] x 120 percent
Low end	Marketing Logistics x 80 percent	Forrester[a] x 80 percent

[a]Forrester estimates of business-to-business Internet sales.

Source: GAO.

The Taxability of Remote Sales

To estimate the amount of tax due on remote sales, we apportioned a share of total remote and Internet sales to each state and then applied each state's tax exemptions and rates to those sales. We allocated sales across states by assuming that each state's share of sales to individuals is proportionate to the state's share of total disposable income and that each state's share of sales to businesses is proportionate to the state's share of total state product.[6] We made this allocation for each product and service

[6]The distribution across states of personal income, disposable income, and state product is so highly correlated that our aggregate results would be the same regardless of which of these factors we used to apportion sales.

category. We then determined which categories of products and services are taxed by each state. Our main sources for state exemptions were CCH's 1999 US Master Sales and Use Tax Guide for goods, the Federation of Tax Administrators' 1996 Update for the Sales Taxation of Services for services, and the Research Institute of America's 1999 All States Tax Handbook. We supplemented these sources with information obtained from individual state revenue departments.

We made additional adjustments to reflect the fact that some sales are exempted on the basis of the type of purchaser or the type of use. These purchaser and use exemptions are important for estimating what proportion of business-to-business remote sales are taxable. Our sources of sales estimates did not disaggregate them by type of purchaser or types of use. In order to estimate the percentage of business-to-business sales that were exempt, we used the input-output tables compiled by the U.S. Department of Commerce.[7] The Use Table shows the interindustry transactions of the U.S. economy for 1996 and provides detailed information on the composition of inputs and the distribution of outputs of all major U.S. industries. We used parts of the "Intermediate Use" column of this table to estimate the share of inputs for key industries that are exempted as raw materials, or inputs that are exempted because they are incorporated into the final product. We used parts of the "Gross Private Fixed Investment" column to estimate the share of industry inputs that are purchases of machinery and other equipment that are also exempted from sales and use taxes by many states. The input-output tables also provide detailed information on the percentage of each industry's output that are exported, sold to federal and state governments, and sold for consumption. We used these data to estimate the share of each major industry's output that should be included in calculations of business-to-business sales that are relevant for sales and use tax purposes.

On the basis of our analysis of the input-output data, we used the following ranges of assumptions in our scenarios for each product category in the Forrester business-to-business Internet sales estimates. The numbers in parentheses indicate the percent of sales assumed to be not taxed. Purchases by tax-exempt entities, such as governments and charitable organizations, are reflected in the percentages.

- Computing and electronics (35-55 percent not taxed)
- Motor vehicles (70-80 percent not taxed)
- Paper and office products (50-65 percent not taxed)

[7]Table 2, Survey of Current Business (Jan. 2000), pp. 56-65.

- Industrial equipment (65-85 percent not taxed in states that exempt machinery used for manufacturing; 50-70 percent not taxed in the remaining states)
- Petrochemicals, shipping and warehousing, pharmaceutical and medical products, construction, and heavy industries (90-100 percent not taxed)
- Food and agriculture and consumer goods (95-100 percent not taxed)
- Aerospace and defense (85-100 percent not taxed)
- Utilities (100 percent not taxed in the states that completely exempt utilities; 60-90 percent not taxed in the states that exempt only utilities purchased by manufacturers; 40-60 percent not taxed in states that do not exempt utilities at all).

In addition we assumed that between zero and 6 percent of business-to-consumer sales were to tax-exempt entities. These assumptions are based on our analysis of the Commerce Department data and opinions obtained from state revenue officials.

The Extent to Which Remote Sellers Already Collect Tax

To estimate seller collection rates for selected categories of Internet and other remote sales, we followed an approach similar to that used in earlier studies by ACIR and the Pennsylvania Department of Revenue. We made separate estimates for all remote sales and for Internet sellers because a somewhat different population of firms dominates in each case. To make our estimate for all remote sales, we obtained information from 96 of the largest remote sellers from Marketing Logistics' 1998 list of leading sellers to determine the states in which they collect sales taxes. We grouped the companies that responded by product category and distributed their sales across states. We were then able to estimate what percent of sales in each product category in each state was made by taxpaying sellers. We used the ratios of the respondents' sales to Marketing Logistics' estimates of total remote sales in each product category to determine how reliable our estimates were. For the five categories in which the respondents' sales represented at least 40 percent of total sales, we used our specific collection rate estimate in our model. We grouped the remaining categories into a separate "other consumer goods" category and estimated one rate for that category. In order to reflect the significant margin of error around our estimates, in our lower scenario we used collection rates that were 25 percent below our estimates; in the higher scenario we assumed rates that were 25 percent above our estimates. Table I.2 shows the nexus assumptions we used for selected categories of all remote sales.

Table I.2: Seller Collection Rate Estimates for Selected Categories of All Business-to-Consumer Remote Sales

Category	Seller collection rate for Higher scenario	Lower scenario
Apparel	29%	48%
Auto service clubs	73	100
Department stores and broad range catalogues	59	98
Computer hardware	14	24
Computer software	11	19
Other consumer goods	35	58

Source: GAO estimates.

For other categories of sales, where we could not obtain sufficient data from companies, but where discussions with tax officials led us to believe that collection rates would be high, we assigned collection rates. Specifically, for the following categories, we assumed a 100-percent seller collection rate in our lower scenario and a 75-percent collection rate in our higher scenario: cable television, direct broadcasting satellite services, and insurance.

We followed a similar approach for estimating seller collection rates for business-to-consumer Internet sales. We obtained information from 86 of the companies on Stores.org's 1999 list of the top 100 Internet retailers. We used Forrester's estimates of business-to-consumer Internet sales in 1999 to estimate the product category shares represented by our respondents. Table I.3 shows the seller collection rate assumptions for our scenarios that were based on our empirical estimates.

Table I.3: Seller Collection Rate Estimates for Selected Categories of Business-to-Consumer Internet Sales

Category	Seller collection rate for Higher scenario	Lower scenario
Apparel	34%	57%
Books/videos/music	13	22
Computer software	28	46
Computer hardware	14	23
Other consumer goods	22	36

Source: GAO estimates.

We could not find appropriate data to estimate collection rates for the business-to-business Internet sales categories used by Forrester. We assumed the following ranges of seller collection rates for each of the Forrester industrial categories (after examining the more detailed subcategories contained in each):

- Computing and electronics, consumer goods, food and agriculture, industrial equipment, paper and office products, and pharmaceuticals (25-50 percent);
- Aerospace and defense, construction, and heavy industries (70-90 percent);
- Petrochemicals, shipping and warehousing, and utilities (75-95 percent);
- Motor vehicles (85-100 percent).

Other analysts who have estimated the revenue losses associated with Internet and other remote sales have used a variety of assumptions regarding the proportion of tax already being paid. However, they have not always specified what portion sellers pay and what portion purchasers pay. Bruce and Fox assumed that 100 percent of the tax due on the Internet sales of automobiles to businesses and consumers are being collected. They assume that 50 percent of the tax due on all other Internet sales to businesses and 10 percent of the tax due on all other Internet sales to individual consumers are being collected either from the sellers or from the purchasers. Cline and Neubig assumed that no significant amount of tax is going uncollected on Internet sales to businesses, while nearly 11 percent of the tax due on Internet sales to consumers is being collected from either sellers or purchasers. Goolsbee and Zittrain also assumed that no significant losses result from business-to-business Internet sales, but they assumed that no tax is collected on sales to consumers. None of these authors cited empirical evidence for these assumptions, though authors of the first two studies referred to discussions with private sector tax experts.

The Extent to Which Purchasers Already Pay Tax

There is a wide range of opinion regarding the compliance rate of business purchasers. One state official we contacted believes the rate is close to 100 percent; another believes it to be around 65 percent. The range of assumptions used in previous studies is similarly wide. As noted above, Cline and Neubig, and Goolsbee and Zittrain have assumed that almost all taxes owed on business-to-business sales are being paid. In contrast, Bruce and Fox assume that only 50 percent is being paid on most purchases, while 100 percent is being paid on purchases of motor vehicles. Neither the Pennsylvania Department of Revenue nor the ACIR estimated the rate of compliance on the part of purchasers, although both acknowledged that there would be some compliance on the part of business purchasers.

In contrast to the wide range of opinion that exists with respect to the compliance of business purchasers, there was a wide consensus among previous studies and the state officials, who provided us estimates that use tax compliance by individual purchasers was extremely low. However, there was also a wide consensus that compliance with the use tax on

motor vehicles was close to 100 percent because the taxes must be paid before those vehicles can be registered.[8]

For our scenarios, we used assumptions for the business purchaser compliance rate that range from 50 to 95 percent on all products, with the previously stated exception for motor vehicles, where the range is from 85 to 100 percent. We used assumptions for the consumer purchaser compliance rate that range from zero to 5 percent. The business-to-consumer estimates that we used for Internet and all remote sales did not show motor vehicle sales separately.

Auction Sales

The Forrester Internet sales estimates that we use in our scenarios include sales that businesses make through auction sites, but they exclude person-to-person auction sales. We exclude those sales under the assumption that state tax authorities would not have any more success collecting from individuals who sell over the Internet than they do from individuals who purchase over the Internet. The latter already have an responsibility to pay any tax that is owed on auction purchases. Boston Consulting Group estimates that person-to-person auction sales of collectibles will total $6 billion in 2000. If all of these sales were taxable, the total state and local sales tax owed on them would be about $0.4 billion. However, almost all states exempt "occasional" sales (other than motor vehicles, vessels, and aircraft) made by persons not engaged in business.

Behavioral Response

Our estimates are based on the assumption that the same volume of Internet and remote sales would have occurred even if taxes were collected on all of those sales. This assumption ignores consumer's response to the reduction in taxes paid when purchases shift to the Internet, and leads to an upward bias in our estimates of revenue loss. In addition, there are several ways in which the existence of and growth in the Internet has changed the behavior of consumers and businesses. First, given the added convenience and lower prices associated with purchasing certain goods over the Internet, it is likely that the volume of those sales has increased over what would have occurred in the absence of Internet and other remote outlets. In addition, the rapid growth of the Internet has also changed the geographic pattern if not the overall level of retail activity in the United States. To the extent that these effects have increased retail sales over what would have occurred in the absence of the Internet, this would lead to an upward bias in our results. We were unable to find sufficient evidence to allow us to adjust for these different changes.

[8]The reason why we assume less than 100-percent compliance in our higher scenario is that the motor vehicles category in the Forrester data includes some sales of automotive parts.

Sensitivity Analysis

Tables I.4 and I.5 show the revenue losses for 2000 and 2003 that we calculated using various combinations of the assumptions and sales estimates described above. They illustrate the effects of changing individual assumptions while holding everything else constant. For example, the third cell of the first row shows the $9.1 billion loss that we obtained by combining a higher end estimate for total remote sales and assumptions that all tended to increase the revenue loss. The third cell of the second row shows that if we kept everything the same as in the prior scenario, with the exception of using our lower rather than higher set of seller collection rates, the revenue loss would fall to $5.6 billion.

Table I.4: State and Local Sales Tax Losses for All Remote Sales and Internet Sales Alone in 2000

Dollars in billions

	Lower sales		Higher sales	
Scenario	**All remote**	**Internet**	**All remote**	**Internet**
All higher scenario assumptions	**$6.1**	**$2.5**	**$9.1**	**$3.8**
All higher scenario assumptions except for				
Seller collection rates	3.7	1.7	5.6	2.5
Purchaser compliance	3.0	0.7	4.5	1.1
Purchaser exemptions	4.8	1.8	7.2	2.8
Displacement rates	No change	1.0	No change	1.5
All lower scenario assumptions	**1.6**	**0.3**	**2.4**	**0.5**
All lower scenario assumptions except for				
Seller collection rates	2.7	0.3	4.1	0.6
Purchaser compliance	2.9	0.5	4.4	0.8
Purchaser exemptions	1.8	0.3	2.7	0.5
Displacement rates	No change	0.4	No change	0.7

Source: GAO estimates.

Table I.5: State and Local Sales Tax Losses for All Remote Sales and Internet Sales Alone in 2003

Dollars in billions

	Lower sales		Higher sales	
Scenario	**All remote**	**Internet**	**All remote**	**Internet**
All higher scenario assumptions	**$13.6**	**$7.8**	**$20.4**	**$12.4**
All higher scenario assumptions except for				
Seller collection rates	8.0	5.0	12.0	8.0
Purchaser compliance	4.7	2.5	7.1	4.4
Purchaser exemptions	9.8	5.6	14.8	9.0
Displacement rates	No change	3.3	No change	5.4
All lower scenario assumptions	**2.5**	**1.0**	**3.6**	**1.9**
All lower scenario assumptions except for				
Seller collection rates	4.1	1.3	6.2	2.4
Purchaser compliance	5.8	1.7	8.8	2.9
Purchaser exemptions	2.8	1.1	4.1	2.0
Displacement rates	No change	1.6	No change	2.9

Source: GAO estimates.

Constitutional Restrictions on State Authority to Impose Sales and Use Taxes

Commerce and Due Process Clauses

The authority of the states to impose sales and use taxes is limited by the U. S. Constitution. The Commerce Clause of Article I and the Due Process Clause of the 14th Amendment are the principal constitutional challenges to these taxes.[1] These two provisions directly impact the ability of the states to tax nonresidents and interstate commerce. Both provisions require a sufficient connection between the state and the taxpayer it seeks to tax or the seller on which the state seeks to impose a responsibility to collect a use tax in order for the tax to be upheld.

Under the Commerce Clause, Congress has sole authority to regulate commerce with foreign nations, among the states, and with the Indian tribes. Accordingly, the Commerce Clause prevents the states from interfering with or unduly burdening interstate commerce through the use of its taxing authority. The Supreme Court's interpretation of this restriction (the Complete Auto test) provides that a state tax does not unduly burden interstate commerce if it is applied to an activity with a substantial connection or "nexus" with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the state.[2]

Under the Due Process Clause, states may not deprive any person of life, liberty, or property without due process of law. This restriction limits the territorial reach of the states' taxing authority to persons, property, and business transactions within their jurisdictions. The Supreme Court's interpretation of this restriction requires some definite link, some minimum connection or "nexus," between a state and the person, property, or transaction it seeks to tax.[3]

Considerable case law has evolved addressing the differing constitutional requirements. Two Supreme Court cases are particularly relevant to the discussion of the Commerce Clause and Due Process Clause challenges to state imposition of use tax collection the responsibility on out-of-state sellers. These two cases, National Bellas Hess v. Department of Revenue of

[1]Commerce Clause, Sec. 8, Cl. 3, Art. I and Due Process Clause, Sec. 1, amend. XIV. Additional constitutional restraints on state taxation include the Import-Export Clause that prevents states from imposing duties on imports or exports without congressional consent; the Privileges and Immunities Clause that prevents states from imposing greater burdens on nonresidents than on residents; the Supremacy Clause that prevents state taxing statutes from contravening federal laws, regulations, or treaties; the First Amendment that prevents states from discriminating against free speech or freedom of religion; and the Equal Protection Clause of the 14th Amendment that prevents states from making unfair classifications.

[2]Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1977).

[3]Miller Brothers Co. v. Maryland, 347 U.S. 347 (1954).

Illinois , 386 U.S. 753 (1967), and, more recently, Quill Corp. v. North Dakota, 504 U.S. 298 (1992), address the "nexus" requirements for taxation of interstate transactions.

National Bellas Hess Addresses Nexus Standards for Mail-order Sellers

The National Bellas Hess company was a mail-order house with its principal place of business in Missouri. It had neither outlets (nor any tangible property, real or personal) in Illinois nor sales representatives physically located there to sell or take orders. Twice-a-year catalogs were mailed to the company's customers throughout the United States, including Illinois. Customers mailed orders for the goods to the National Bellas Hess plant in Missouri. The ordered goods were then sent to the customers either by mail or common carrier.

The State of Illinois obtained a judgment from its highest court requiring National Bellas Hess to collect and pay to the state a use tax imposed upon its consumers who purchased goods for use within Illinois. National Bellas Hess argued that imposition of the responsibility to collect a use tax collection violated the Due Process Clause and created an unconstitutional burden upon interstate commerce.

The Supreme Court reversed the ruling of Illinois' highest court, noting, first, that National Bellas Hess' two constitutional challenges were closely related. According to the Court, the test for whether a particular state tax invades the exclusive authority of Congress to regulate commerce among the states and the test for a state's compliance with the requirements of due process in this area are similar. The Court pointed to its previous holding that state taxation falling on interstate commerce can only be justified to bear a fair share of the cost of the local government whose protection it enjoys.

In determining whether a state tax falls within the confines of the Due Process Clause, the Court noted its previous holding that the controlling question is whether the state has given anything for which it can ask a return. According to the Court, the same principles had been held applicable in determining the power of a state to impose the burdens of collecting use taxes upon interstate sales. There, too, the Court noted, the Constitution requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax.[4]

[4]There was no question of the connection or link between the State and the person it sought to tax, i.e. Illinois residents who used the goods purchased from National Bellas Hess. Although National Bellas Hess was not the person being directly taxed (but rather it was asked to collect the tax from the user),

The Court then noted that in applying these principles it had upheld the power of a state to impose liability upon an out-of-state seller to collect a local use tax in many circumstances, but it had never upheld the power to impose this duty upon a seller whose only connection with customers in the state was by common carrier or the U.S. mail. The Court refused to repudiate here the distinction it had previously drawn between mail order sellers with retail outlets, solicitors, or property within a state and those sellers who do no more than communicate with customers in the state by mail or common carrier. Accordingly, the Court concluded that imposition on National Bellas Hess of the responsibility for use tax collecting a use tax, in fact, unconstitutional on both grounds.

Quill Draws Distinction Between Due Process Clause and Commerce Clause Requirements

In Quill v. North Dakota, the Court reviewed its earlier decision in National Bellas Hess. The Court used this opportunity to draw a clearer distinction between the Due Process Clause and Commerce Clause nexus requirements.

The Quill Corporation was a mail order house with offices and warehouse in Illinois, California, and Georgia. It had neither outlets nor tangible property in North Dakota, nor did any of its employees work or reside there. Quill sold office equipment and supplies through catalogs and flyers, advertisements in national periodicals, and telephone calls. Its annual national sales exceeded $200 million of which almost $1 million was made from about 3,000 customers in North Dakota. Quill delivered all of its merchandise to its North Dakota customers by mail or by common carrier from its out-of-state locations.

Quill took the position that North Dakota did not have the power to compel it to collect a use tax from its North Dakota customers. A North Dakota trial court agreed with Quill finding the case indistinguishable from the Supreme Court's decision in National Bellas Hess.

North Dakota's highest court reversed the trial court, concluding that wholesale changes in both the economy and the law made it inappropriate to follow the National Bellas Hess decision. The principal economic change noted by the court was the remarkable growth of the mail-order business from a relatively inconsequential market in 1967 to a "goliath" with annual sales that reached $183.3 billion in 1989. Equally important in the court's view were changes it perceived in the legal landscape. The court maintained that the Supreme Court's subsequent four-part

it was, however, made directly liable for the payment of the tax whether collected or not. Ill. Rev. Stat. C. 120, sec. 439.8 (1965).

Commerce Clause analysis (the Complete Auto test) indicated that the Commerce Clause no longer mandated the sort of physical presence nexus suggested in National Bellas Hess. The North Dakota court further concluded that the Due Process requirement of a minimum connection to establish nexus was no longer a separate requirement but was encompassed within the Complete Auto test. According to the court, the relevant inquiry was whether the state had provided some protection, opportunities, or benefit from which it could expect a return. With regard to the case at hand, the court emphasized that North Dakota had created an economic climate that fostered demand for Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill each year into the state.

The U.S. Supreme Court reversed the ruling of North Dakota's highest court. The Court agreed with the North Dakota court's conclusion that the Due Process Clause did not bar enforcement of that state's use tax against Quill. The Court concluded, however, that the state's enforcement of the use tax against Quill placed an unconstitutional burden on interstate commerce. The Court noted that although it had not always been precise in distinguishing between the two, the Due Process Clause and Commerce Clause reflect different constitutional concerns and are analytically distinct.

The Supreme Court agreed with the North Dakota court that nexus is not synonymous with physical presence for due process purposes and overruled its previous holdings to that effect. The Court noted that its due process jurisprudence had evolved substantially in the 25 years since National Bellas Hess and that the relevant inquiry was whether a defendant had minimum contacts with a jurisdiction such that maintenance of the suit did not offend traditional notions of fair play and substantial justice. The Court concluded that Quill's widespread and continuous solicitation in North Dakota made the magnitude of its contacts more than sufficient for due process purposes.

In contrast, the Court upheld its previous holding in National Bellas Hess to the extent that it required physical presence in the Commerce Clause context. The Court first concluded that its decision in National Bellas Hess is not inconsistent with Complete Auto and other recent cases. The Court noted that under Complete Auto's four-part test, a tax will be sustained against a Commerce Clause challenge so long as the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. According to the Court, National Bellas

Hess concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing state are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause. Using this bright-line, physical presence, rule the Court then concluded that the imposition of the responsibility to collect the use on Quill placed an unconstitutional burden on interstate commerce.

After concluding its decision on the case, the Supreme Court noted in Quill that Congress may not only be better qualified to resolve the underlying issue in the case, but also is the one with the ultimate power to do so. The Court stated that no matter how it evaluated the burdens that use taxes impose on interstate commerce, Congress remains free to disagree. The Court further noted that in recent years, Congress had in fact considered legislation that would legislatively overrule the National Bellas Hess decision. The Court surmised that Congress' decision not to take action in that direction may have been dictated by its holding in National Bellas Hess that the Due Process Clause prohibits states from imposing such use tax collection responsibilities.[5] The Court noted that since the Quill decision overruled that aspect of National Bellas Hess, Congress, with the sole authority to regulate commerce among the states, could freely decide whether, when, and to what extent the states could burden interstate mail-order concerns with a duty to collect use taxes.

National Geographic Holds That Nexus Need Not Relate to Taxed Activity

The Supreme Court, in ruling on the National Geographic Society case, held that the activity or physical presence that established a company's nexus did not have to be related to the taxed activity.[6] National Geographic Society's mail-order office that made merchandise sales to customers in California was separate from the Society's magazine sales and advertising office that maintained offices in the state. The Court held that the maintenance of the two magazine sales offices in California with advertising copy in the range of $1 million annually adequately established a relationship of nexus between the Society and the State of California. This connection was sufficient for California to require National Geographic to collect the California use tax. In so holding, the Court rejected the Society's argument that there must be a relationship between the taxed activity and the seller's activity within the state.

[5]While Congress has plenary power to regulate commerce among the states and thus may authorize state actions that burden interstate commerce, it does not similarly have the power to authorize violations of the Due Process Clause.

[6]National Geographic Society v. State Board of Equalization, 430 U.S. 551 (1977).

State Court Holds Deminimis Contact Insufficient to Establish Nexus

While National Geographic held that the activity that established the company's nexus did not have to relate to the taxed activity, a state court has ruled on circumstances that do not constitute sufficient nexus. For example, the Connecticut Supreme Court ruled that insignificant property in a state does not necessarily establish nexus. Cally Curtis, a California firm, rented film to customers in Connecticut for a 3-day preview period before purchase. The court ruled that the presence of film for the preview period was de minimis contact and insufficient to support a nexus relationship between Cally Curtis and Connecticut.[7] The U.S. Supreme Court declined review of this case.[8]

Dual Entity Arrangements

Several cases have examined the use of dual entity arrangements and whether nexus can be imputed to a vendor that does not appear to have sufficient nexus to support a state sales and use tax collection responsibility because of its affiliation, through a parent-subsidiary or brother-sister relationship, with another vendor that does have nexus with the state. The issue has generally turned on whether the two affiliated companies are separate and distinct entities and whether the affiliated company that has sufficient nexus with the state has acted as an agent for the company that does not have nexus. Two case examples follow.

In SFA Folio Collections, Inc. v. Bannon, 217 Conn. 220 (1991), Saks and Company, a New York Corporation, owned both Folio, a New York Corporation whose mail-order business sold to Connecticut customers but had no physical presence in that state, and Saks-Stamford, a separate corporation operating a retail store in Connecticut. The Connecticut Supreme Court rejected the argument of Connecticut's Revenue Commission that because these separate entities were linked by their common parent, Saks and Company, their separate existence should be disregarded and that they should be treated as one enterprise for the purpose of establishing nexus. The Connecticut court noted that the commissioner's argument demonstrated a misunderstanding of a fundamental principle underlying our system of taxation, which is that taxpayers may arrange their affairs to minimize their tax liabilities. According to the court, this included careful planning of both transactions and corporate structure. The Supreme Court declined review of this case.[9]

[7] Cally Curtis Co. v. Groppo, 214 Conn 292 (1990).

[8] Writ of certiorari denied, Commissioner of Revenue Services v. Cally Curtis Co., 498 U.S. 824 (1990).

[9] Writ of certiorari denied, Commissioner of Revenue Services v.SFA Folio Collections, 501 U.S. 1223 (1991).

Similarly, in Bloomingdale's v. Department of Revenue, 527 Pa. 347 (1991), the Pennsylvania Court found that there was not sufficient nexus between an out-of-state mail-order company, Bloomingdale's By Mail, which did mail-order business in the state but had no physical presence there, even though its parent company, Bloomingdale's, did own and operate retail stores in the state. In that case, the Department of Revenue argued that Bloomingdale's By Mail's separate corporate existence from Bloomingdale's department stores was a mere legal formality. The court pointed to previous court holdings of a parent/subsidiary relationship with nothing more would not justify disregarding the separate corporate identity. According to the court, the issue turned on whether the Bloomingdale's department stores had acted as an agent or representative for Bloomingdale's By Mail.[10] The Pennsylvania court concluded though that the revenue department had not established the existence of an agency relationship between Bloomingdale's department stores and Bloomingdale's By Mail. The Supreme Court declined review of this case.[11]

[10]In response to the Department of Revenue's argument that catalog purchasers had been allowed to return merchandise directly to the local department store, the court found that such returns appeared to be "an aberration from normal practice," so it did not reach a conclusion as to whether nexus could have been established if such returns had been a regular practice.

[11]Writ of certiorari denied, Pennsylvania Department of Revenue v. Bloomingdale's By Mail, 504 U.S. 955 (1992).

General Sales Tax Provisions

Figure III.1: Sales and Use Tax Treatment of Selected Goods That Can Be Sold by Remote Sellers, 1999

State	State rate	Apparel	Grocery	Computer software			Medicine		Newsprint	
			Food	Canned	Custom	Modified	Prescription	Nonprescription	Newspapers	Periodicals
Alabama	4.0				E	E	E			
Arizona	5.0		E		E	E	E			
Arkansas	4.625						E		E[r]	E[r]
California	6.0	[a]	E		E	E	E		[s]	[s]
Colorado	3.0		E		E	E	E		E	
Connecticut	6.0	[b]	E				E		E[t]	E
District of Columbia	5.75		E				E	E	[u]	
Florida	6.0		E		E	E	E	E	E[v]	E[v]
Georgia	4.0		E		E	E	E			
Hawaii	4.0						E			
Idaho	5.0	[c]			E	E	E		[w]	[w]
Illinois	6.25		[o]		E	E		[o]	E	E
Indiana	5.0	[d]	E		E		E		E	
Iowa	5.0		E		E	E	E		E	
Kansas	4.9				E	E	E			
Kentucky	6.0		E		E	E	E			
Louisiana	4.0		[p]				E		[aj]	
Maine	5.5		E		E	E	E		E	E
Maryland	5.0		E		E	E	E	E	[x]	
Massachusetts	5.0	[e]	E		E	E	E		E	E
Michigan	6.0		E		E	E	E		E[y]	E
Minnesota	6.5	E[f]	E		E	E	E		E	E[z]
Mississippi	7.0						E		E	E
Missouri	4.225				E		E			
Nebraska	5.0		E				E		E[aa]	E
Nevada	6.5		E		E	E	E		E	
New Jersey	6.0	E[g]	E		E	E	E	E	E	E[ab]

State	State rate	Apparel	Grocery	Computer software			Medicine		Newsprint	
			Food	Canned	Custom	Modified	Prescription	Nonprescription	Newspapers	Periodicals
New Mexico	5.0						E		E	
New York	4.0	[h]	E		E	E	E	E	E	E
North Carolina	4.0		[q]		E	E	E		E[ac]	[ac]
North Dakota	5.0		E		E	E	E		E	
Ohio	5.0		E				E		E	E[ad]
Oklahoma	4.5				E		E		E	E
Pennsylvania	6.0	E[i]	E		E	E	E	E	E	E
Rhode Island	7.0	E[j]	E		E		E	E	E	E
South Carolina	5.0						E		E	
South Dakota	4.0						E			
Tennessee	6.0	[k]					E		E[ae]	E
Texas	6.25	[l]	E				E		E[af]	E
Utah	4.75				E	E	E		E	
Vermont	5.0		E		E	E	E		E	
Virginia	3.5	[m]			E	E	E	E	E[ag]	E[ag]
Washington	6.5	[n]	E		E	E	E		E	
West Virginia	6.0								[ah]	
Wisconsin	5.0		E		E	E	E		E	E[ai]
Wyoming	4.0				E		E			

[a] California exempts new clothing to nonprofits for elementary students and used clothing sold by certain thrift stores.
[b] Connecticut exempts employee safety apparel; clothing and footware less than $50, but not athletic or protective items.
[c] Idaho exempts clothing and footware purchased by nonprofits to provide free clothing.
[d] Indiana exempts protective clothes for contaminant production and prevention.
[e] Massachusetts exempts up to $175 for any article of clothing or footware, excluding athletic activity and protective ware.
[f] Minnesota taxes athletic, sporting, recreational items, jewelry, and articles made of fur.
[g] New Jersey taxes clothing and footware with fur or pelt at chief valued component and athletic goods and equipment.
[h] New York exempts clothing articles costing less than $110, articles less than $500 the third week in January 1999, and certain safety apparel.
[i] Pennsylvania taxes fur articles, ornamental, formal ware, and sports clothing.
[j] Rhode Island taxes athletic or protective use apparel and footware.
[k] Tennessee exempts used clothing sold by certain profits.
[l] Texas exempts clothing used directly in production and with a useful life of 6 months.
[m] Virginia exempts safety apparel furnished gratuitously by manufacturers to production line employees.

[n] Washington exempts wearing apparel used as sample for display.
[o] Illinois taxes groceries and nonprescriptions drugs at the reduce rate of 1 percent.
[p] Louisiana taxes groceries and nonprescriptions drugs at the reduced rate of 3 percent.
[r] Arkansas exempts subscription periodicals.
[q] North Carolina taxes groceries at the reduced rate of 2 percent.
[s] California exempts newspapers and periodicals sold by subscription for free distribution published by tax-exempts.
[t] Connecticut exempts subscription periodicals.
[u] D.C. Exempts newspapers distributed by publisher at no charge.
[v] Florida exempts subscription newspaper and periodical sales.
[w] Idaho taxes single-copy sales and subscriptions if the single price of the newspaper or magazine exceeds 11 cents.
[x] Maryland exempts newspapers distributed by publisher at no charge.
[y] Michigan exempts newspapers if sent by second-class mail, controlled circulation, qualified to accept legal notices established less than 2 years, and
[z] Minnesota exempts periodicals sold by subscription.
[aa] Nebraska exempts newspapers issued at average intervals not exceeding 1 week and containing general interest matters and current events.
[ab] New Jersey exempts periodicals issued at state intervals at least 4 times a year.
[ac] North Carolina exempts newspapers sold by street vendors or carriers making door-to-door deliveries and periodicals sold by door-to-door vendors.
[ad] Ohio exempts subscription periodicals shipped by second-class mail and sales or transfers of periodicals distributed as controlled circulation.
[ae] Tennessee exempts newspapers on newsprint or bond paper distributed biweekly or more often; and periodicals distributed by mail or common carriers.
[af] Texas exempts newspapers if average sales price for each copy over a 30-day period does not exceed 75 cents and subscriptions to magazine.
[ag] Virginia taxes newspapers and periodicals sold at newstands.
[ah] West Virginia exempts newspapers if delivered to consumers by route carriers.
[ai] Wisconsin exempts newspapers delivered by route carriers.
[aj] Louisiana sales newspapers at a reduced rate.

Source: 1999 U.S. Master Sales and Use Tax Guide, 1999, CCH Incorporated.

Sales tax programs vary state-by-state in the treatment of goods and services sold to customers in their jurisdictions. Generally, state and local governments tax the sale of goods unless the state specifically exempts the sale. On the other hand, sales of services are generally untaxed unless the state specifically includes these sales in its tax base. Tables III.1 and III.2 show the variance in tax treatment for some goods and services that can be sold by remote sellers. The general sales tax rates also vary by state and by local jurisdiction. The combined state and local sales tax rate can vary for certain jurisdictions within the same state. Table III.3 shows the state general sales tax rate for states with sales tax programs and the rates for some of the larger cities in these states. Four states—Delaware, Oregon, New Hampshire, and Montana—do not have general sales tax program. Alaska has no state sales tax program, but local jurisdictions may impose sales and use taxes.

Table III.2: General Sales and Use Tax Treatment for Selected Services That Can be Sold by Remote Sellers, 1996

States	AL	AK	AZ	AR	CA	CO	CT	DE	DC	FL	GA
State rate	4	0	5	4.5	6	3	6	0.4	6	6	4
Travel services	E	nd	E	E	E	E	E	E	E	E	E
Utility services											
Interstate telephone	E	nd	E		E	E		E		[d]	E
Cellar telephone	E	nd			E			4.25		7	
Finance services[a]	E	nd	E	E	E	E	E	[b]	E[c]	E	E
Personal services											
Debt counseling	E	nd	E	E	E	E			E	E	E
900 number services	E	nd	E		E	E			E	E	E
Tax return preparation	E	nd	E	E	E	E	E		E	E	E
Business services											
Marketing & advertising	E	nd	E	E	E	E	E		E	E	E
Credit information	E	nd	E		E	E				E	E
Employment agencies	E	nd	E	E	E	E			E	E	E
Lobbying/consulting	E	nd	E	E	E	E			E	E	E
Photocopy services		nd			7.25	E					E
Photo finishing		nd			7.25						
Printing		nd			7.25			nd			
Typesetting (industrial)	E	nd		E	7.25	E			E	E	E
Public relations, consulting, contract telemarketing	E	nd	E	E	E	E	[i]		E	E	E
Telephone answering service	E	nd	E		E	E			E	E	E
Computers software, services, and access											
Canned software	E	nd			7.25			nd			
Modified software	E	nd		E	7.25					E	
Custom (material)		nd	E		E	E				E	
Custom (services)	E	nd	E	E	E	E				E	E
Data processing and information	E	nd	E	E	[j]	E				[k]	E
Mainframe access	E	nd	E	E	E	E					E
Admissions & amusements											
Pari-mutuel racing	E	nd		6.5	E	E	10	E	N/A		
School sports		nd	E	E	E	E	10	E			E
Professional sports		nd			E	E	10				
Cultural		nd			E	E	10		E		
Films/tapes (theaters)	E	nd	E	E	E		E	2.3	E	E	E
Video tapes (home)		nd		5.5	7.25			2.3			
Cable TV services	E		E		E	E		4.25	9.7		E
Service contracts	E		E		7.25						E

Table III.2: (cont.)

HI	ID	IL	IN	IA	KS	KY	LA	ME	MD	MA	MI	MN	MS	MO
4	5	6.25	5	5	4.9	6	4	6	5	5	4	6.5	7	4.225
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	5	E	E		E	E	E	E		6		E	E
5.885	E	5					3				6			
[e]	E	E	E	[f]	E	E	E	E	E	[g]	E	E	E	[h]
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	5	E		E		E				E	E	E	E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	E	E	E	E	E	E	E		E	E	E	E	E
	E	E	E		E	E	E	E	E	E	E	E	E	E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
		E	E								6			E
			E								6			
0.5		E									6			
		E	E	E		E		E	E	E	6	E		E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	E	E			E	E	E		E	E	E		E
											6			
	E			E		E				E	E			
	E	E		E		E			E	E	6			E
	E	E	E	E	E	E			E	E	E	E		E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
	E	E	E	E	E	E	E	E	E	E	E	E	E	E
n/a		E	E			15	E	E	10	E	E			
		E	E			E	E	E	10	E	E			
		E	E					E	10	E	E			
		E	E					E	10	E	E		E	
	E	E	E	E	E	E		E	E	E	E	E		E
		E									6			E
	E	E				E	E			E	E			E
			E			E		E	E	E	E	E		E

Table III.2: (cont.)

States	MT	NE	NV	NH	NJ	NM	NY	NC	ND	OH	OK
State rate	0	5	6.5	0	6	5	4	4	5	5	4.5
Travel services	nd	E	E	nd	E	E	E	E	E	E	E
Utility services											
Interstate telephone	E	E	E	6		4.25	E	E			
Cellar telephone	1.8		E	6				3			nd
Finance services[a]		E	E	nd	E	[m]	E	E	E	E	E
Personal services											
Debt counseling	nd	E	E	nd	E		E	E	E	E	E
900 number services	nd		E	6				E	E		
Tax return preparation	nd	E	E	nd	E		E	E	E	E	E
Business services											
Marketing & advertising	nd	E	E	nd	E	[n]	E	E	E	E	E
Credit information	nd	E	E	nd	E			E	E	E	E
Employment agencies	nd	E	E	nd	E		E	E	E		E
Lobbying/consulting	nd	E	E	nd	E		E	E	E	E	E
Photocopy services	nd			nd							
Photo finishing	nd			nd							
Printing	nd			nd							
Typesetting (industrial)	nd		E	nd	E		E	E	E	E	E
Public relations, consulting, contract telemarketing	nd	E	E	nd	E		E	E	E	E	E
Telephone answering service	nd	E	E	nd				E	E	E	E
Computers software, services, and access											
Canned software	nd			nd							
Modified software	nd		E	nd	E				E		
Custom (material)	nd		E	nd	E			E	E	E	
Custom (services)	nd		E	nd	E		E	E	E	E	E
Data processing and information	nd	E	E	nd				E	E		E
Mainframe access	nd	E	E	nd	E		E	nd	E	E	E
Admissions & amusements											
Pari-mutuel racing	1		E	nd	E		E	3		E	14.5
School sports	nd		E	nd				3	E	E	
Professional sports	5		E	nd				3		E	
Cultural	nd		E	nd			E	3		E	
Films/tapes (theaters)	E	E	E	nd	E	E		E	E	E	E
Video tapes (home)	E			nd							
Cable TV services	nd		E	nd	E		E	E	E	E	E
Service contracts	nd		E	nd				E	E		E

Table III.2: (cont.)

OR	PA	RI	SC	SD	TN	TX	UT	VT	VA	WA	WV	WI	WY
0	6	7	5	4	6	6.25	5	5	4.5	6.5	6	5	4
na	E	E	E	E	E	E	E	E	E	0.287		E	E
na													
na			E	E			E	E	E		E		E
na	[o]						[p]	E	E		E		E
na	E	E	E	[q]	E	[r]	E	E	E	[s]	E[t]	E	E
na													
na	E	E	E		E	E	E	E	E	2		E	E
na			10				E	E	E	2	E		E
na	E	E	E		E	E	E	E	E	2		E	E
na													
na	E	E	E	[u]	E	E	E	E	E	2	E	E	E
na		E			E		E	E	E			E	E
na		E	E		E	E	E	E	E	1.829		E	E
na		E	E		E	E	E	E	E	2	E	E	E
na							4.875						
na			E				4.875		E				
na							4.875						
na	E	E	E					E		2			E
na	E	E	E		E	E	E	E	E	[v]		E	E
na					E		E	E	E	1.829		E	E
na													
na							4.875						
na							E		E		E		
na							E		E		E		
na		E					E	E	E	2	E	E	E
na		E	[w]		E		E	E	E	2	E[x]	E	E
na			E		E		E	E	E	2	E	E	E
na													
na	E		E				4.875		E	1.829			
na	E	E		E		E	4.875	E	E	2			
na	E	E				E	4.875		E	2			
na	E	E					4.875		E				
na	E	E	E	E		E	E	E	E	2	E	E	E
na							4.875		4.5				
na	E						E		E	1.829			E
na		E					4.875	E					E

Note 1: The space is blank if the jurisdiction taxes the sale at the general rate.

Note 2: Exempt indicated by “E.”

No data available indicated by “nd.”

Not applicable indicated by “na.”

[a]Financial services include service charges of banking institutions, insurance services, investment counseling, loan broker fees, and ticker tape financial reporting.

[b]Delaware exempts bank service charges and insurance services but taxes investment counseling, loan broker fees, and ticker tape financial reporting.

[c]D.C. exempts bank service charges, insurance services, investment counseling and loan broker fees but taxes ticker tape financial reporting.

[d]Florida exempts residential interstate telephone services but taxes business interstate telephone services.

[e]Hawaii exempts banking service charges but taxes the other financial services.

[f]Iowa taxes banking service charges and investment counseling but exempts the other financial services.

[g]Massachusetts taxes ticker tape financial reporting.

[h]Montana taxes insurance services at 2.75 percent.

[i]Connecticut taxes public relations services but exempts telemarketing service contracts.

[j]California taxes data processing services and exempts information services.

[k]Florida taxes information services and exempts data processing service.

[l]Montana has no general sales tax but taxes insurance services at 2.75 percent.

[m]New Mexico exempts insurance services and loan broker fees but taxes bank service charges, investment counseling, and ticker tape financial reporting.

[n]New Mexico exempts national radio and television advertising but tax other advertising services.

[o]Pennsylvania reported no data for residential cellular telephone services but that it taxes industrial cellular telephone services.

[p]Utah taxes cellular telephone services for industrial use at 4.875 percent and for residential use at 5 percent.

[q]South Dakota exempts bank service charges

[r]Texas exempts bank service charges, investment counseling, loan broker fees but taxes insurance services and ticker tape financial services.

[s]Washington taxes financial services, telemarketing, and public relations at lower rates (2 percent to 1.829 percent).

[t]West Virginia exempts banking service charges, investment counseling; and taxes insurance services at 3 percent, loan broker fees and ticker tape financial reporting at 6 percent.

[u]South Dakota exempts advertising time and space but taxes agency fees.

[v]Washington taxes marketing and advertising at reduced rates from .506 percent to 1.829.

[w]South Carolina exempts data processing services but taxes information services.

[x]West Virginia exempts data processing services but taxes information services.

Source: Federation of Tax Administrators, Sales Taxation of Services: 1996 Update, April 1997.

Table III.3: State and Local General Sales Tax Rates and Combined Rates for Selected Cities, March 1999

		Rates				
State[a]	City (county)	State	County	City	Other	Combined
Alabama	Birmingham (Jefferson)	4.000	1.000	3.000		8.000
	Huntsville (Madison)	4.000	1.000	3.500		8.500
	Mobile (Mobile)	4.000	1.000	4.000		9.000
	Montgomery (Montgomery)	4.000	1.500	2.500		8.000
	Tuscaloosa (Tuscaloosa)	4.000	2.000	2.000		8.000
Alaska	Juneau			5.000		5.000
Arizona	Phoenix (Maricopa)	5.000	0.700	1.300		7.000
	Tucson (Pima)	5.000		2.000		7.000
	Yuma (Yuma)	5.000	1.000	1.700		7.700
Arkansas	Fort Smith (Sebastian)	4.625	1.000	1.500		7.125
	Little Rock (Pulaski)	4.625	1.000	0.500		6.125
	North Little Rock (Pulaski)	4.625	1.000			5.625
California	Bakersfield (Kern)	6.000	1.250			7.250
	Los Angeles (Los Angeles)	6.000	1.250		1.00	8.250
	Sacramento (Sacramento)	6.000	1.250		0.50	7.750
	San Diego (San Diego)	6.000	1.250		0.50	7.750
	San Francisco (San Francisco)	6.000	1.250		1.25	8.500
	San Jose (Santa Clara)	6.000	1.250		1.00	8.250
Colorado	Aurora (Arapahoe)	3.000		3.750	0.80	7.550
	Boulder (Boulder)	3.000	0.400	3.260	0.80	7.460
	Colorado Springs (El Paso)	3.000	1.000	2.100		6.100
	Denver (Denver)	3.000		3.500	0.80	7.300
	Fort Collins (Larimer)	3.000	0.750	3.000		6.750
Connecticut	No local general sales taxes	6.000				6.000
Delaware	No state or local general sales taxes					0
District of Columbia				5.750		5.750
Florida	Fort Lauderdale (Broward)	6.000				6.000
	Jacksonville (Duval)	6.000	0.500			6.500
	Miami (Dade)	6.000	0.500			6.500
	Miami Beach (Dade)	6.000	0.500			6.500
	Orlando (Orange)	6.000				6.000
Florida	St. Petersburg (Pinellas)	6.000	1.000			7.000
	Tallahassee (Leon)	6.000	1.000			7.000
	Tampa (Hillsborough)	6.000	0.750	0.250		7.000
Georgia	Atlanta (Fulton)	4.000	1.000		2.00	7.000
	Columbus (Muscogee)	4.000	1.000		2.00	7.000
	Savannah (Chatham)	4.000	1.000	1.000		6.000
Hawaii	No local general sales taxes	4.000				4.000
Idaho	Boise	5.000				5.000
	Ketchum	5.000		1.000		6.000
	Sun Valley	5.000		2.000		7.000
Illinois	Chicago (Cook)	6.250	0.750	1.000	0.75	8.750
	Decatur (Macon)	6.250		1.250		7.500
	Peoria (Peoria)	6.250		1.000		7.250
	Rockford (Winnebago)	6.250				6.250
Indiana	No local general sales taxes	5.000				5.000

		Rates				
State[a]	**City (county)**	**State**	**County**	**City**	**Other**	**Combined**
Iowa	Cedar Rapids (Linn)	5.000				5.000
	Davenport (Scott)	5.000		1.000		6.000
	Des Moines (Polk)	5.000				5.000
	Dubuque (Dubuque)	5.000		1.000		6.000
Kansas	Kansas City (Wyandotte)	4.900	1.000	1.000		6.900
	Topeka (Shawnee)	4.900	0.250	1.000		6.150
	Wichita (Sedgwick)	4.900	1.000			5.900
Kentucky	No local general sales taxes	6.000				6.000
Louisiana	Baton Rouge (East Baton Rouge)	4.000	4.940			8.940
	Monroe (Ouachita)	4.000	4.500			8.500
	New Orleans (Orleans)	4.000	5.000			9.000
	Shreveport (Caddo)	4.000	4.250			8.250
Maine	No local general sales taxes	5.500				5.500
Maryland	No local general sales taxes	5.000				5.000
Massachusetts	No local general sales taxes	5.000				5.000
Michigan	No local general sales taxes	6.000				6.000
Minnesota	Duluth (St. Louis)	6.500		1.000		7.500
	Minneapolis (Hennepin)	6.500		0.500		7.000
	Rochester (Olmsted)	6.500		0.500		7.000
	St. Paul (Ramsey)	6.500		0.500		7.000
Mississippi	No local general sales taxes	7.000				7.000
Missouri	Independence (Jackson)	4.225	0.875	1.000		6.100
	Kansas City (Jackson)	4.225	0.875	1.500	0.50	7.100
	St. Louis	4.225		1.875	0.75	6.850
	Springfield (Greene)	4.225	0.875	1.250	0.125	6.475
Montana	No state or local general sales taxes					0
Nebraska	Lincoln (Lancaster)	5.000		1.500		6.500
	Omaha (Douglas)	5.000		1.500		6.500
Nevada	Las Vegas (Clark)	6.500	0.500			7.000
	Reno (Washoe)	6.500	0.500			7.000
New Hampshire	No state or local general sales taxes					0
New Jersey	No local general sales taxes	6.000				6.000
New Mexico	Albuquerque (Bernalillo)	5.000	0.250	0.813		5.563
New Mexico	Santa Fe (Santa Fe)	5.000	0.375	1.438		6.313
New York	Albany (Albany)	4.000	4.000			8.000
	Buffalo (Erie)	4.000	4.000			8.000
	New York	4.000		4.000	0.25	8.250
	Rochester (Monroe)	4.000	4.000			8.000
	Syracuse (Onondaga)	4.000	3.000			7.000
	Yonkers (Westchester)	4.000	1.500	2.500	0.25	8.250
North Carolina	Charlotte (Mecklenburg)	4.000	2.000			6.000
	Durham (Durham)	4.000	2.000			6.000
	Raleigh (Wake)	4.000	2.000			6.000
	Winston-Salem (Forsyth)	4.000	2.000			6.000
North Dakota	Fargo (Cass)	5.000				5.000
Ohio	Akron (Summit)	5.000	0.750			5.750
	Cincinnati (Hamilton)	5.000	1.000			6.000
	Cleveland (Cuyahoga)	5.000	2.000			7.000

State[a]	City (county)	Rates				
		State	County	City	Other	Combined
	Columbus (Franklin)	5.000	0.750			5.750
	Dayton (Montgomery)	5.000	1.500			6.500
	Toledo (Lucas)	5.000	1.250			6.250
	Youngstown (Mahoning)	5.000	0.500			5.500
Oklahoma	Oklahoma City (Oklahoma City)	4.500		3.875		8.375
	Tulsa (Tulsa)	4.500	0.417	3.000		7.917
Oregon	No state or local general sales taxes					0
Pennsylvania	Philadelphia (City and County)	6.000		1.000		7.000
	No other local sales taxes					0
Rhode Island	No local general sales taxes	7.000				7.000
South Carolina	Charleston (Charleston)	5.000	1.000			6.000
South Dakota	Rapid City (Pennington)	4.000		2.000		6.000
	Sioux Falls (Minnehaha)	4.000		2.000		6.000
Tennessee	Chattanooga (Hamilton)	6.000	2.250			8.250
	Knoxville (Knox)	6.000	2.250			8.250
	Memphis (Shelby)	6.000	2.250			8.250
	Nashville (Davidson)	6.000	2.250			8.250
Texas	Austin (Travis)	6.250		1.000	1.00	8.250
	Corpus Christi (Nueces)	6.250	0.125	1.000	0.50	7.875
	Dallas (Dallas)	6.250		1.000	1.00	8.250
	Fort Worth (Tarrant)	6.250	0.500	1.000	0.50	8.250
	Houston (Harris)	6.250		1.000	1.00	8.250
	San Antonio (Bexar)	6.250		1.000	0.50	7.750
	Wichita Falls (Wichita)	6.250		2.000		8.250
Utah	Ogden (Weber)	4.750	1.000		0.25	6.000
	Provo (Utah)	4.750	1.000		0.25	6.000
	Salt Lake City (Salt Lake)	4.750	1.000		0.60	6.350
Vermont	No local general sales taxes	5.000				5.000
Virginia	Alexandria	3.500		1.000		4.500
	Fairfax County	3.500	1.000			4.500
	Newport News	3.500		1.000		4.500
	Norfolk	3.500		1.000		4.500
	Richmond	3.500		1.000		4.500
Washington	Seattle (King)	6.500		1.700	0.40	8.600
	Spokane (Spokane)	6.500		1.600		8.100
	Tacoma (Pierce)	6.500		1.500	0.40	8.400
West Virginia	No local general sales taxes	6.000				6.000
Wisconsin	Madison (Dane)	5.000	0.500			5.500
	Milwaukee (Milwaukee)	5.000	0.500		0.10	5.600
	Racine (Racine)	5.000			0.10	5.100
Wyoming	Cheyenne (Laramie)	4.000	1.000			5.000
	Lincoln	4.000	1.000			5.000

[a]Includes the 50 states and the District of Columbia.

Sources: Significant Features of Fiscal Federalism, Volume 1—Budget Processes and Tax Systems (American Council on International Relations, 1995), p. x and 1999 U.S. Master Sales and Use Tax Guide (CCH Incorporated, Mar. 1999).

State and Local Government Reliance on Sales Tax Revenue

Table IV.1: State Government Reliance on Sales Tax Revenue, 1998

		General sales tax revenue as a percentage of		
State	Dollars in millions	Total tax revenue	Total general own-source revenue	Total general revenue
United States	**155,971**	**32.9**	**25.0**	**18.0**
Alabama	1,571	27.4	18.7	12.6
Alaska	0	0	0	0
Arizona	3,050	43.9	36.0	25.8
Arkansas	1,514	37.3	28.3	19.6
California	21,302	31.5	26.6	19.2
Colorado	1,531	26.0	18.7	14.0
Connecticut	3,032	32.3	26.5	21.0
Delaware	0	0	0	0
Florida	12,924	57.4	45.4	35.1
Georgia	3,993	34.5	27.6	19.8
Hawaii	1,425	44.9	33.2	26.0
Idaho	653	31.7	23.9	18.2
Illinois	5,596	28.3	22.5	16.6
Indiana	3,156[a]	32.4	24.0	18.4
Iowa	1,529	31.8	23.1	17.3
Kansas	1,619	34.7	27.3	20.8
Kentucky	1,981	27.8	21.2	15.3
Louisiana	1,981	32.6	20.6	14.5
Maine	831	35.1	26.3	18.2
Maryland	2,161	23.5	17.9	13.9
Massachusetts	2,963	20.4	15.3	11.5
Michigan	7,573	35.7	27.5	21.0
Minnesota	3,244	28.2	23.3	18.2
Mississippi	2,035	48.0	37.3	24.2
Missouri	2,628	32.0	24.7	17.7
Montana	0	0	0	0
Nebraska	920	34.9	25.9	19.0
Nevada	1,657	53.2	44.7	35.9
New Hampshire	0	0	0	0
New Jersey	4,766	30.5	21.7	16.8
New Mexico	1,455	40.7	27.6	20.4
New York	7,615	21.1	16.2	9.4
North Carolina	3,273	23.6	19.1	13.7
North Dakota	309	28.7	18.8	12.2
Ohio	5,531	31.4	23.7	17.1
Oklahoma	1,328	25.1	19.3	14.1
Oregon	0	0	0	0
Pennsylvania	6,313	30.6	23.2	17.1
Rhode Island	526	28.9	20	13.9
South Carolina	2,163	38.1	27.1	18.9
South Dakota	443	53.1	33.2	21.1
Tennessee	4,028	57.6	45.7	28.6
Texas	12,474	50.6	37.3	26.0
Utah	1,312	37.5	26.6	19.8

State	Dollars in millions	General sales tax revenue as a percentage of Total tax revenue	Total general own-source revenue	Total general revenue
Vermont	195	20.3	13.3	8.9
Virginia	2,225	21.1	14.4	11.5
Washington	6,909[b]	58.5	46.6	36.2
West Virginia	856	28.4	20.8	13.8
Wisconsin	3,047	27.3	21.2	16.8
Wyoming	335	39.2	22.4	14.4

[a]Indiana figures include $547 million in corporate gross income tax revenue.

[b]Washington figures include $1,854 million in business and occupation gross receipt tax revenue.

Source: GAO based on Bureau of the Census data.

Table IV.2: Local Government Reliance on Sales Tax Revenue, 1995-96

State	Dollars in millions	General sales tax revenue as a percentage of Total tax revenue	Total general own-source revenue	Total general revenue
United States	29,709	11.0	6.8	4.2
Alabama	961	40.5	19.0	11.5
Alaska	109	13.9	7.7	4.7
Arizona	731	19.5	12.3	7.0
Arkansas	301	26.2	13.7	7.9
California	4,315	15.2	7.8	4.2
Colorado	1,289	29.1	18.0	12.3
Connecticut	0	0.0	0.0	0.0
Delaware	0	0.0	0.0	0.0
District of Columbia	468	18.8	15.4	9.5
Florida	356	2.6	1.3	0.9
Georgia	1,525	21.7	12.1	8.2
Hawaii	0	0.0	0.0	0.0
Idaho	0	0.0	0.0	0.0
Illinois	1,135	7.5	5.3	3.6
Indiana	0	0.0	0.0	0.0
Iowa	60	2.4	1.4	0.9
Kansas	289	12.1	7.1	4.6
Kentucky	0	0.0	0.0	0.0
Louisiana	1,928	54.2	31.8	20.5
Maine	0	0.0	0.0	0.0
Maryland	0	0.0	0.0	0.0
Massachusetts	0	0.0	0.0	0.0
Michigan	0	0.0	0.0	0.0
Minnesota	25	0.6	0.3	0.2
Mississippi	1	0.1	0.0	0.0
Missouri	1,015	22.7	14.7	9.5

State	Dollars in millions	General sales tax revenue as a percentage of Total tax revenue	Total general own-source revenue	Total general revenue
Montana	0	0.0	0.0	0.0
Nebraska	143	7.9	5.1	3.7
Nevada	83	6.1	3.0	1.8
New Hampshire	0	0.0	0.0	0.0
New Jersey	0	0.0	0.0	0.0
New Mexico	302	37.1	18.7	8.1
New York	6,171	16.1	11.5	7.5
North Carolina	884	19.2	9.0	5.3
North Dakota	30	6.6	4.0	2.4
Ohio	932	7.6	5.2	3.3
Oklahoma	813	41.9	21.7	13.1
Oregon	0	0.0	0.0	0.0
Pennsylvania	100	0.8	0.6	0.3
Rhode Island	0	0.0	0.0	0.0
South Carolina	54	2.4	1.1	0.7
South Dakota	121	17.1	12.6	9.1
Tennessee	1,110	29.1	15.2	10.3
Texas	2,340	12.3	7.5	5.2
Utah	247	17.8	10.1	6.0
Vermont	0	0.0	0.0	0.0
Virginia	594	8.8	6.3	4.2
Washington	1,058	21.7	11.6	6.8
West Virginia	0	0.0	0.0	0.0
Wisconsin	144	2.6	1.7	1.0
Wyoming	75	16.5	7.8	4.7

Source: GAO based on Bureau of the Census data.

State and Local Government Sales and Use Tax Losses

There are additional sources of uncertainty related to state estimates. For example, we assume that purchaser compliance rates are the same across states.

Table V.1: State and Local Sales and Use Tax Losses for All Remote Sales and Internet Sales Alone in 2000

Dollars in millions

	Lower scenario		Higher scenario	
	All remote	Internet	All remote	Internet
Alabama	58	5	167	54
Alaska	1	[a]	6	2
Arizona	52	5	169	58
Arkansas	29	2	84	25
California	298	23	1446	533
Colorado	52	5	159	56
Connecticut	61	5	191	62
Delaware	0	0	0	0
District of Columbia	13	2	48	21
Florida	120	13	503	179
Georgia	80	7	270	95
Hawaii	12	1	38	12
Idaho	11	1	33	11
Illinois	117	13	545	212
Indiana	52	5	177	62
Iowa	26	2	94	31
Kansas	31	3	103	33
Kentucky	43	4	135	45
Louisiana	77	7	237	81
Maine	13	1	41	14
Maryland	65	5	199	60
Massachusetts	66	6	221	83
Michigan	109	10	343	125
Minnesota	49	5	192	72
Mississippi	34	3	99	32
Missouri	65	6	205	69
Montana	0	0	0	0
Nebraska	22	2	67	22
Nevada	21	2	77	29
New Hampshire	0	0	0	0
New Jersey	101	10	346	130
New Mexico	21	2	65	21
New York	196	22	889	357
North Carolina	62	6	231	84
North Dakota	7	1	21	7
Ohio	108	11	375	141
Oklahoma	48	4	137	45
Oregon	0	0	0	0
Pennsylvania	102	12	381	156
Rhode Island	12	1	40	15
South Carolina	36	3	114	36

	Lower scenario		Higher scenario	
	All remote	Internet	All remote	Internet
South Dakota	7	1	26	8
Tennessee	50	6	239	85
Texas	252	26	992	342
Utah	18	2	65	23
Vermont	7	1	19	6
Virginia	47	5	175	69
Washington	82	8	284	98
West Virginia	21	2	62	18
Wisconsin	51	5	173	58
Wyoming	6	[a]	18	6

Note: Estimates are combined state and local losses.

[a]Less than 500,000.

Source: GAO estimates.

Table V.2: State and Local Sales and Use Tax Losses for All Remote Sales and Internet Sales Alone in 2003

Dollars in millions

	Lower scenario		Higher scenario	
	All remote	Internet	All remote	Internet
Alabama	144	19	415	184
Alaska	2	1	13	8
Arizona	130	18	420	191
Arkansas	67	8	200	85
California	686	86	3650	1720
Colorado	130	18	394	181
Connecticut	150	20	466	205
Delaware	0	0	0	0
District of Columbia	37	6	128	66
Florida	321	48	1279	595
Georgia	200	28	675	312
Hawaii	30	4	91	39
Idaho	28	4	82	36
Illinois	298	44	1389	671
Indiana	134	19	444	204
Iowa	64	9	230	103
Kansas	81	11	253	111
Kentucky	105	14	333	150
Louisiana	191	26	593	270
Maine	34	5	103	46
Maryland	154	20	472	199
Massachusetts	172	25	574	274
Michigan	276	39	882	415
Minnesota	129	19	489	232
Mississippi	86	12	246	109
Missouri	164	23	512	232
Montana	0	0	0	0
Nebraska	52	7	164	73

	Lower scenario		Higher scenario	
	All remote	Internet	All remote	Internet
Nevada	57	8	199	95
New Hampshire	0	0	0	0
New Jersey	256	37	879	419
New Mexico	51	7	158	70
New York	521	81	2339	1,155
North Carolina	166	25	593	279
North Dakota	17	2	50	22
Ohio	286	43	955	454
Oklahoma	121	16	343	154
Oregon	0	0	0	0
Pennsylvania	281	45	1,012	505
Rhode Island	30	5	101	48
South Carolina	93	13	276	120
South Dakota	19	3	62	27
Tennessee	139	22	606	282
Texas	655	96	2466	1125
Utah	47	7	162	75
Vermont	16	2	46	20
Virginia	123	18	458	224
Washington	213	30	712	326
West Virginia	52	7	147	62
Wisconsin	126	17	424	190
Wyoming	14	2	45	21

Note: Estimates are combined state and local losses.

Source: GAO estimates.

List of Contacts

Private Sector Research Groups

ActiveMedia
Boston Consulting Group
Cyber Dialogue
Direct Marketing Association
Emarketer
Ernst & Young
Forrester
Giga
IDC
Jupiter
Yankee Group

National Organizations Representing the Public Sector

Federation of Tax Administrators
Government Finance Officers Association
National Association of Counties
National Association of State Budget Officers
National Conference of State Legislatures
National Governors' Association
National League of Cities
National Tax Association
Multistate Tax Commission

Industry Representatives

Census, Retail and Wholesale Indicator Program
CommerceNet
Direct Marketing Association
Economic and Statistics Administration
National Retail Federation
National Association of Manufacturers
Sears, Roebuck and Company
The Internet Tax Fairness Coalition

Department of Commerce

Census Bureau
Secretary of Electronic Commerce

Department of the Treasury

Office of International Tax Counsel

States

California, State Board of Equalization
Connecticut, Department of Revenue Services
Florida, Department of Revenue, Research and Analysis Division
Georgia, Department of Revenue, Research and Analysis Division

Kansas, Department of Revenue, Policy and Research
Michigan, Bureau of Revenue, Revenue and Tax Analysis
Minnesota, Department of Revenue, Sales and Use Tax
Nebraska, Department of Revenue, Research and Audit Divisions
New Mexico, Taxation and Revenue Department
New York, State Department of Taxation and Finance, Tax Policy and Analysis
North Carolina, Department of Revenue, Tax Research Division
Ohio, Department of Taxation, Tax Analysis and Local Government Distribution Division
Pennsylvania, Department of Revenue, Fiscal Policy and Analysis
Texas, Comptroller of Public Accounts, Fiscal Management
Utah, State Tax Commission, Economic and Statistical Unit
Washington, Department of Revenue, Taxpayer Services
Wisconsin, Department of Revenue, Division of Income, Sales and Excise Taxes

Academics and Others

Lynda McDonald Applegate, Economic Council on Information Management and Technology (ECIMT), and Harvard Business School
Bradley S. Dugger, ECIMT, and Chief of Information Systems, Tennessee
Paul E. Rummell, ECIMT and President's Chief Executive Officer, RLG Netperformance
Bill Fox, University of Tennessee
Austan Goolsbee, University of Chicago
Charles McClure, Jr., Hoover Institution
Tom Neubig and Robert Cline, Ernst & Young
Holley Ulbrich, ACIR studies on Taxation of Out-of-State Mail Order Sales

GAO Contacts and Staff Acknowledgments

GAO Contacts

James R. White, (202) 512-9110
James A. Wozny, (202) 512-9110

Acknowledgments

In addition to those named above, Helen Fauntleroy-Branch, Tara Carter, Daniel E. Coates, Shirley A. Jones, Kirsten Landeryou, MacDonald R. Phillips, Loren Yager, Jena Sinkfield, Jennifer Trombley, Katherine Wheeler Raheb made key contributions to this report.

Ordering Copies of GAO Reports

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Order by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (202) 512-6061, or TDD (202) 512-2537.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touch-tone phone. A recorded menu will provide information on how to obtain these lists.

Viewing GAO Reports on the Internet

For information on how to access GAO reports on the INTERNET, send e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

http://www.gao.gov

Reporting Fraud, Waste, and Abuse in Federal Programs

To contact GAO FraudNET use:

Web site: http://www.gao.gov/fraudnet/fraudnet.htm
E-Mail: fraudnet@gao.gov
Telephone: 1-800-424-5454 (automated answering system)

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested