



NATIONAL RETAIL FEDERATION

THE LEVEL-PLAYING FIELD AND BEYOND:

THE NATIONAL RETAIL FEDERATION'S

POSITION PAPER

ON THE FRAMEWORK FOR A FAIR, WORKABLE, AND SIMPLIFIED

SALES AND USE TAX SYSTEM

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INTRODUCTION

The National Retail Federation (NRF) is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people -- about 1 in 5 American workers -- and registered 1999 sales of \$3 trillion. NRF is strongly committed to efforts to create a fair, workable, and simplified sales and use tax system for the twenty-first century and beyond. NRF believes the creation of such a system is critical to the future of a vibrant retail sector in which vigorous competition occurs without regard to artificial tax advantages or barriers as well as the continued fiscal health of our nation's state and local governments. With these goals in mind, NRF has set forth below its view of the essential elements of a viable sales and use tax system for the future.

I. GUIDING PRINCIPLES

NRF believes it is important at the outset to set forth the principles that should guide the effort to create a fair, workable, and simplified sales tax and use tax system. NRF recognizes that general principles do not always provide answers to specific problems, in part because there is sometimes tension between the implications of such principles. This can happen because the specific steps necessary to implement the general principles can sometimes conflict with each other. For example the goal of economic neutrality (treating all similar forms of commerce similarly) may conflict with the goal of administrative simplicity if one form of commerce is not amenable to the same rules appropriate for another form of commerce. NRF nevertheless believes that it is important to articulate the guiding principles if for no other reason than to have a standard against which to measure the soundness of any proposed sales and use tax regime.

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

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

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

- Certainty and simplicity – tax rules should be clear and simple so that both taxpayers and tax collectors understand them.
- Effectiveness and fairness – taxation systems should be designed to minimize the possibility of evasion or avoidance.
- Flexibility – taxation systems should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.¹

II. THE ESSENTIAL ELEMENTS OF A FAIR, WORKABLE, AND SIMPLIFIED SALES AND USE TAX SYSTEM

A. Uniform Tax Base Definitions

A fair, workable, and simplified sales and use tax system must have a uniform set of tax base definitions across state lines. A uniform set of tax base definitions does not mean identical tax bases. States would retain the authority, within the limits of the uniform set of definitions of goods and services, to determine which goods and services they wish to tax. However, the definitions themselves must be identical and comprehensive, i.e., there can be no variation from state to state in the identification of particular goods and services, and classification of goods and services must leave no good or service unidentified.²

Other elements of the uniform set of tax base definitions must assure that there are no local variations from the state approach (i.e., if a good or service is taxable or exempt at the state level it must likewise be taxable or exempt at the local level); that changes in the base (taxable or nontaxable) be made only annually, effective January 1 of the succeeding year, and communicated at least six months prior to the effective date; that “bundled” transactions (involving more than one identifiable category of goods and/or services for a single price) be either fully taxable or fully exempt based on whether more or less than 50% of the charge is for the taxable items; that the taxability of the goods or service not depend on the price of the item, the age of the buyer, or whether the item upon which services are performed is new or used; that taxes, finance charges, and shipping and handling charges be treated uniformly (e.g., always excluded, always included, or excluded if separately stated); that coupons be treated uniformly (e.g., vendor coupons reduce price, manufacturer’s coupons do not); that taxes be refunded on returns without limitation and that a clear rule for trade-ins (taxable on net or gross) be

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

² This does not mean that the list of identifiable goods and services must be long. Indeed, NRF strongly believes that the number of identifiable categories of goods and services should be kept as short as possible. To account for goods and services that do not clearly fall within one of the identifiable categories, there would be a catchall or default category, and a state would have to determine whether goods or services falling into the residual category were taxable or nontaxable.

stated. The foregoing list is intended to be illustrative rather than exhaustive and may be subject to modification as the process of refining the tax base progresses.³

B. Uniform Exemption Rules

Closely related to---and equally important as---a uniform set of tax base definitions to the creation of a fair, workable, and simplified sales and use tax system is the adoption of uniform exemption rules and procedures. In other words, wholly apart from the initial determination of whether the good or service sold is taxable or exempt, see Section A above, there must be a uniform methodology for determining whether a particular purchase is exempt because of the status of the purchaser (e.g., a church) or the purchase (e.g., a sale for resale). The uniform exemption certificate or certificates must be available in electronic as well as tangible form and there must be standard procedures under which a seller, by complying with such procedures, will be protected from any liability arising out of the transaction.

In this connection, NRF believes that the Streamlined Sales Tax Project appears to have properly identified the salient features of a redesigned exemption administration process. Specifically, the Project is currently developing a process under which (1) a buyer will claim exemption by completion of a standard set of information (on paper or electronically) indicating the identity of the purchaser and the reason for the exemption and (2) a seller will not be held liable or responsible for verifying the validity of the claimed exemption or the “good faith” of the purchaser. The obligation will be on the state to police any potential exemption abuse through the information provided when the exemption is claimed. A procedure as that outlined above will be essential if the Streamlined Sales Tax is to receive NRF endorsement.

C. Uniform and Centralized Administration

An indispensable feature of a fair, workable, and simplified sales and use tax system is the replacement of the existing system of multiple and inconsistent administrative requirements with a uniform and, to a certain extent, centralized administrative structure. Specifically, this system must include a centralized, one-stop multistate registration system for vendors; uniform tax returns and remittance forms (electronic as well as paper); uniform audit procedures; and state administration of all state and local taxes.

³It has been suggested that no menu of taxable and exempt goods and services, unless it just contains a handful of items, can address the problem of those who make catalog purchases and wish to pay by check, so that there will be no interaction with any tax administration software, that ordinarily would facilitate the tax determination and collection process. While this is just one of many details that will have to be ironed out in developing a final proposal for a fair, workable, and simplified sales and use tax system, such transactions could be addressed through a general default principle (e.g., fully exempt, or fully taxable at the purchaser’s state rate) or by making tax remittance information readily available at a toll-free number and, in any event, by holding vendors harmless from any tax liabilities in underpayment circumstances.

D. Limited Number of State Rates

One of the most nettlesome sources of complexity and uncertainty in the existing system of state and local sales and use taxes is the multiplicity of tax rates in the more than 7600 state and local jurisdictions across the country that impose sales and use taxes. It is often difficult for a multi-state vendor to determine the appropriate rate for the appropriate jurisdiction when the tax equation is further complicated by multiple, sometime conflicting, definitions for goods and services. Indeed, it was this very problem that led the U.S. Supreme Court in *Bellas Hess* and *Quill* to hold that requiring remote sellers to collect use taxes would impose a significant and impermissible burden on interstate commerce.

In order to create a fair, workable tax system in which all sellers can be required to collect sales taxes, any compliance burden must be minimized by limiting the number of state sales tax rates per state. NRF recognizes the legitimate needs of local governments for tax revenues and believes that some flexibility on the number of rates within a state must be made to ensure local needs are met. This "limited number" of rates is, however, a problem that is most appropriately left for the states and localities to resolve on an individual basis in light of their particular circumstances. While one-rate-per-state may be the preferred solution to existing tax simplification problems, NRF believes that simplification can still be achieved with a limited number of rates per state, assuming the states and locals can agree to adopt uniform definitions for goods and services, limit the frequency of rate changes, and that software is made available to vendors that is capable of synthesizing this information quickly and accurately.

E. Uniform Sourcing Rules

A fair, workable, and simplified sales and use tax system must have uniform (and simple) rules for attributing transactions to particular jurisdictions. NRF believes that the governing rule for sourcing transactions in this new system, which is designed to be a tax on consumption, is and should continue to be the destination principle. NRF also believes, consistent with its view that there should only be one rate per state, see Section D above, that goods and services should be sourced only to the state level. With respect to sales of tangible personal property, the "ship to" address, where known or readily available, should be used to determine the destination state. With respect to sales of digital products or services, there should be a hierarchy of rules depending on the nature of the transaction and the information readily available to the vendor. Where the seller, at the time and in the ordinary course of the transaction, has knowledge of the actual state of destination or use, the sale would be sourced to that state. Where the actual state of destination or use is not known or readily available, the buyer's billing address, where readily available, would be employed as a proxy for the actual state of destination. Where neither actual state of destination nor the buyer's billing address is known, or readily available, a default rule would apply which would subject the transaction to a single tax rate that is the same for all sellers in all states.

NRF recognizes that the foregoing sourcing principles provide no more than the framework within which more precise corollaries of these principles must be spelled out. Among other issues that must be addressed are the treatment of the sale of digital products or services for use in multiple destinations and the treatment of gifts. With regard to the former, which largely involves business-to-business transactions, NRF strongly believes that the increased use of the direct-pay mechanism, which must be an integral part of a redesigned sales and use tax system, will provide considerable assistance in resolving this issue. Under a direct-pay procedure, in which registered businesses self-assess sales and use tax, business purchasers of digital products or services would assign a portion the tax to the state or states in which it used the digital products or services. With respect to gifts, they should be treated as any other transaction and taxed based on destination.

F. Uniform Collection Obligations: The Level Playing Field

A fair, workable, and simplified sales and use tax system requires that all vendors, except those making de minimis sales into a state, collect sales and use tax on all sales into the state regardless of their physical presence in a state. There is no sound tax policy reason for exempting goods or services from sales tax in a state merely because they have been purchased from a remote vendor. Indeed, as a matter of law such goods or services currently are fully subject to use tax. The only reason such goods or services have enjoyed a de facto exemption is because the U.S. Supreme Court has held that the existing system of sales and use taxation is so complex that it would be a burden on interstate commerce to require the remote seller to comply with varying and often inconsistent rules of thousands of state and local taxing jurisdiction, and states not have successfully induced consumers to remit use taxes voluntarily. With the adoption of the uniform rules and procedures outlined above, those burdens will be eliminated, and states can reasonably require remote vendors to collect tax on sales into their state imposed on a uniform base and at a single rate. Any other rule would create an artificial and unfair tax advantage for those selling from remote locations to the detriment of local retailers and their customers.

G. De Minimis Rule for Small Vendors

Recognizing that small enterprises may have difficulty in complying with even a radically simplified sales and use tax regime, there should be a principle that relieves small vendors from the obligation to collect sales or use taxes on sale into multiple jurisdictions. NRF believes that vendors with less than \$2 - \$5 million in gross annual sales should be relieved of any requirement to collect use taxes into jurisdictions in which they have no physical presence. The \$2 - \$5 million cap should apply to total sales of all entities in a Federal Consolidated Group.

H. Vendor Allowances

A fair, workable, and simplified sales and use tax system must provide for reasonable compensation for all vendors, designed to compensate vendors for their actual costs. To determine those costs, NRF recommends undertaking a joint state/vendor study to determine the actual costs of collection and remittance of sales and use taxes. The study would review costs under the current sales and use tax structure, and what compliance costs would be under a new "simplified" sales and use tax system ultimately adopted by the States. Upon completion, the study would provide data to determine for the States and vendors what compliance costs are, and consequently, what compensation should be provided to vendors.

I. Uniform Procedures for Certifying Software

A fair, workable, and simplified sales and use tax system must provide uniform procedures for certification of software that sellers may rely upon to determine their state sales and use tax obligations and, if they rely upon such software, be held harmless from any additional liability.

J. Interstate Sales Tax Uniformity Commission

A fair, workable, and simplified sales and use tax system must provide for the creation of an Interstate Sales Tax Uniformity Commission to assure that the fair, workable, and simplified system that we create today will continue to be a fair, workable, and simplified system tomorrow. No matter how prescient the designers of a reformed sales and use tax system may be, controversies will inevitably arise in construing those provisions and there will no doubt be need for further refinement of the system in light of experience. For these reasons, NRF believes that it is absolutely essential to create a centralized administrative body empowered to address these questions in an authoritative manner. States must be fully answerable to this body and must therefore waive their Eleventh Amendment immunity if they wish to participate in the redesigned sales and use tax regime that will permit them to require remote vendors to collect sales and use taxes. The body should have representatives from the states and from the business community, including a fair and equitable representation of main street retailers.

K. No Effect on Nexus

No use tax collection obligation imposed on remote sellers in conjunction with the creation of the fair, workable, and simplified sales and use tax system described in this position paper shall be considered in determining whether a seller has nexus with a state for any other tax purpose. Specifically, except as provided above, nothing in this position paper should be read to permit a state:

- (1) to license or regulate any business;
- (2) to require any business to transact intrastate business; or
- (3) to subject any business to any other nexus-based state taxes not specifically or exclusively related the sale of goods or services.

III. CONCLUSION

NRF is strongly committed to helping craft a fair, workable, and simplified sales and use tax system for the twenty-first century and beyond. NRF believes the creation of such a system is critical to the future of a vibrant retail sector in which vigorous competition occurs without regard to artificial tax advantages or barriers as well as the continued fiscal health of our nation's state and local governments. NRF believes the creation of a simplified system should be guided by the principles of: Neutrality, Efficiency, Certainty, Effectiveness, Fairness and Flexibility. The eleven essential elements outlined in Sections A through K above are not a conclusive list, but NRF views each of these elements as critical components of a viable sales and use tax system for the future.

For Additional Information, Please Contact:

**Sarah Whitaker
Senior Director
Government Relations
National Retail Federation
325 7th Street, N.W.
Washington, D.C. 20004
(202) 783-7971
whitakers@nrf.com**