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Taxing Out-of-State Sales: Still a Bad Idea

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The long-running campaign to allow states to collect taxes on sales outside their own borders may heat up soon. Over the next few weeks, Congress will be crafting a catch-all, omnibus spending bill to fund the government for fiscal year 2018. This presents a danger that unpopular legislation that expands tax-collection authority could be tacked on to the must-pass spending bill, with little or no public scrutiny.

Under current tax rules, as articulated by the Supreme court in *Quill v. North Dakota* (1992), states can require businesses to collect sales taxes for them only if those businesses have a physical presence—such as a building, warehouse, or employees—in that state.[1]

Congress must not expand the power of states to compel out-of-state retailers to collect sales taxes. Instead, it should codify the safeguards laid out in *Quill*, ensuring that they will be preserved.

Revenue Grab

State tax collectors have long protested the 1992 *Quill* restriction, arguing that it deprives them of needed revenue. This view recently garnered support from the Trump Administration. In a July 2017 hearing before the Senate Appropriations Committee, Treasury Secretary Steven Mnuchin said that the additional revenue from Internet taxes "could be a very important means for the states to fund infrastructure."[2] However, that hardly guarantees new revenues. This is not free money. Any claimed need for new revenue from interstate taxation should be evaluated with the same skepticism as any other tax increase.

This is not new revenue, respond some proponents, stating that any tax is already due under current law, even if not collected. In fact, in most states, individual consumers are required to pay "use" taxes directly to the state if a retailer does not collect sales tax at the time of purchase. But these obligations are notoriously hard to enforce, and in practice are rarely paid. Those are enforcement challenges for states to resolve without forcing out-of-state retailers to collect taxes on the state's behalf. One thing is clear: If the law is changed to allow states to force out-of-state retailers to collect more taxes, consumers' will pay more taxes. That is a tax increase regardless of how it is labeled.

Does Not Promote Fairness

Brick-and-mortar retailers have a different concern about interstate sales taxes' competitive equality. Under *Quill*, a local brick-and-mortar retailer and an Internet retailer selling remotely to consumers from out of state are treated differently. The first must add taxes to the sales price, while the latter is not required to do so. This puts the brick-and-mortar retailers at an artificial disadvantage, they argue.

Certainly, tax policy should treat like businesses alike. But requiring retailers to collect taxes for all 50 states is no answer. That would just introduce a new disparity as remote sellers struggle to deal with the tax laws of some 10,000 jurisdictions and 46 state tax authorities each with its own tax-reporting requirements.

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http://report.heritage.org/ib4798

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Although the burden of compliance can be reduced through software, significant costs would still be incurred. Resources would be needed for an array of tasks, including handling claims by tax-exempt customers, fielding inquiries from tax authorities, and addressing the inevitable glitches.

Even the simple act of classifying the item being sold can be problematic, with thousands of idiosyncratic distinctions and definitions through each state's tax code. In Wisconsin, the Wisconsin flag as well as the U.S. flag is not subject to tax. All other flags are taxable, unless they are bundled with flagpoles, in which case the rules change yet again.[3]

Moreover, since large retailers with a national presence already collect taxes in just about every jurisdiction, any expansion of the tax collection mandate would largely affect small businesses and individual sellers—those least able to handle the burden.

Regulation without Representation

If states wish to impose costs on their retailers, they should be able to do so. But retailers should not be subject to mandates from states with which they have no physical connection. The reason is clear: The burden—from job losses to reduced investment—imposed on retailers would be borne by the *seller*'s state, not the state imposing the tax. The policymakers imposing the tax would have little accountability for the consequences of their decisions, and little reason to care about losses inflicted on others. Without direct accountability, future sales tax increases could come more easily, and the competitive pressures of neighboring states would be muted.[4]

Strengthening *Quill*

Expanding Internet taxes promises a counterproductive solution to a complex problem. While seeming to level the retail-tax playing field, it likely will create new, even more uneven, burdens, while bulldozing fundamental principles of federalism. Congress should instead strengthen and codify the pro-federalism protections set out in *Quill*.

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1 This study is based on James L. Gattuso, "Taxing Online Sales: Should the Taxman's Grasp Exceed His Reach?" Heritage Foundation *Backgrounder* No. 2817, June 19, 2013, http://www.heritage.org/taxes/report/taxing-online-sales-should-the-taxmans-grasp-exceed-his-reach.

2 Steven T. Mnuchin, "Review of the FY2018 Budget Request for the U.S. Department of the Treasury," Subcommittee on Financial Services and General Government, July 26, 2017, https://www.appropriations.senate.gov/hearings/review-of-the-fy2018-budget-request-for-the-us-department-of-the-treasury (accessed August 17, 2017).

3 State of Wisconsin Department of Revenue, "Exemption for United States Flags and Wisconsin State Flags," https://www.revenue.wi.gov/Pages/TaxPro/news-2010-101108b.aspx (accessed December 14, 2017), and Joseph Bishop-Henchman and Steven Pahuskin, "Happy Flag Day! 14 States Exempt Flags from Their Sales Taxes," Tax Foundation, June 14, 2011, https://taxfoundation.org/happy-flag-day-14-states-exempt-flags-their-sales-taxes-0/ (accessed December 15, 2017).

4 Adam D. Thierer and Veronique de Rugy, "The Internet Tax Solution: Tax Competition, Not Tax Collusion," Cato Institute, October 23, 2003, https://www.cato.org/publications/policy-analysis/internet-tax-solution-tax-competition-not-tax-collusion (accessed December 14, 2017).