SUMMARY DESCRIPTION OF S. 1510

RELATING TO

STATE TAXATION OF INTERSTATE SALES

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON TAXATION AND

DEBT MANAGEMENT

of the

SENATE COMMITTEE ON FINANCE

on November 15, 1985

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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JCX-26-85

INTRODUCTION

The Subcommittee on Taxation and Debt Management of the Senate Committee on Finance has scheduled a public hearing on November 15, 1985, on S. 1510 (introduced by Senator Andrews). This bill would eliminate certain restrictions on States' powers in taxing sales in interstate commerce.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary description of present law, the bill, and the issues raised by the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary Description of S. 1510 Relating to State Taxation of Interstate Sales (JCX-26-85), November 14, 1985.

DESCRIPTION OF THE BILL

Present Law

A State or local government may constitutionally impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. (Approximately 6,400 State and local jurisdictions impose sales and use taxes.[2]) The allowable sales tax authority of a State or local government extends to mail order sales by out-of-state vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction.[3] There are, however, limitations on the methods State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-state vendor, the U.S. Supreme Court has held that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State.[4] In that case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail.[5] The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce.[6] The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

Explanation of Provision

Under the bill, any State (as well as the District of Columbia) or political subdivision of a State would be em-

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[2] Advisory Commission on Intergovernmental Relations, State and Local Taxation of Interstate Mail Order Sales (preliminary draft, revised August 23, 1985), p. 8.

[3] See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

[4] National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967) (henceforth referred to as National Bellas Hess).

[5] Id. at 753.

[6] Id. at 760.

powered to impose a sales or use tax on any interstate sale of tangible personal property, or on the use in such State or subdivision, by a resident thereof, of tangible personal property acquired in an interstate sale. Interstate sales subject to the bill would be those in which tangible personal property, sold by a person located outside of the State or political subdivision, was delivered by common carrier or the United States Postal Service to the purchaser in the State from a point outside of the State.

The bill as introduced does not expressly authorize a State or local government to require that any out-of-state vendor collect and remit sales or use taxes relating to an interstate sale of tangible personal property to which the bill applies. However, the bill is intended to "eliminate restrictions on the power of the states to collect taxes on mail order sales."[7]

The bill would be effective on the date of enactment.

Overview of Issues

The purpose of the bill is to eliminate the disparity that arises from the constitutional limitation on the power of a State or local government to require collection and remission of a sales or use tax by an out-of-state vendor with no sales agents or retail stores in the State. Because State and local governments rely on vendors to collect and remit sales and use taxes on State residents, this constitutional limitation on the collection of these taxes generally has prevented the effective imposition of sales and use taxes on mail order sales by these out-of-state vendors. Accordingly, to the extent that purchasers can avoid sales or use tax liability by making mail order purchases from these out-of-state vendors, such vendors realize a competitive advantage in relation to in-State vendors (as well as out-of-state vendors with sales agents or retail stores in the State).

Some argue that this result is undesirable for two reasons. First, they argue that equal tax treatment of in-State and out-of-state businesses is preferable to providing one type of business with a competitive advantage based solely upon the nonpayment of State taxes. Second, they assert that State and local governments should be assisted in collecting all revenues to which they are entitled, particularly to the extent that their tax bases are affected by out-of-state mail order sales.

Others argue that Federal legislation should not be adopted addressing this issue even if the above arguments

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[7] 131 Cong. Rec. S10184 (daily ed., July 26, 1985) (statement of Sen. Andrews).

generally express the proper policy. They rely principally on two concerns: constitutionality and the administrative burden on vendors.

The constitutional issue arises under National Bellas Hess, the Supreme Court case holding that a State could not require an out-of-state mail order vendor to collect and remit sales or use taxes with respect to its sales. Some note that the Supreme Court based its decision on the fact that interstate commerce "is a domain where Congress alone has the power of regulation and control." Thus, they conclude that Federal legislation authorizing State and local governments to require collection and remission by out-of-state vendors of otherwise allowable sales or use taxes would remove the constitutional defect that the Supreme Court found. Others respond by arguing that National Bellas Hess requires a significant nexus between the out-of-state vendor and the taxing jurisdiction and that, on due process grounds, Congress may not be able constitutionally to dispense with this nexus requirement.

The issue of administrative burden relates to the fact that a mail order vendor, in order to comply with a requirement that it collect and remit sales and use taxes, presumably would have to be familiar with the tax laws in all jurisdictions with respect to which the requirement arose. This could involve significant difficulty in some cases, in light of the multiplicity of sales and use tax rules applying in different States and subdivisions thereof.

The Advisory Commission on Intergovernmental Relations (ACIR) has recommended that Federal legislation be enacted generally similar in intent to S. 1510, but with additional features designed to address these constitutional and administrative concerns. The legislation recommended by ACIR would contain a de minimis rule exempting vendors with national sales, or sales in the destination State, below a threshold dollar amount. In addition, under the recommendation, States in which there are local sales or use taxes would determine a nondiscriminatory single rate, applying to mail order sales and consisting either of the Statewide rate, or of a combined State and local rate that would apply at the option of the vendor.