

# *Special Report*



August 2001

## **FLORIDA JOINS THE STREAMLINED SALES TAX PROJECT: AN IMPORTANT FIRST STEP IN MODERNIZING FLORIDA'S TAX SYSTEM**

---

**The first in a series of *Special Reports* on Modernizing Florida's Tax System  
by  
The Center for a Competitive Florida**

---

**by Richard H. Hunt**

*Richard H. Hunt & Associates, P.A.*

### **Executive Summary**

This first in a series of *Special Reports* by Florida TaxWatch on modernizing Florida's tax system looks at Florida's special, and possibly unique, vulnerability to recent major developments in the economy, in information technology, and in tax jurisprudence which, in converging, are opening great holes in the sales and use tax bases of all the states.

- Florida's sales and use tax collections for 1998, as a percent of its total tax collections, reflects the third highest percentage in the country<sup>1</sup>, making it among the states most dependent upon the continued vitality and effectiveness of that tax. Yet some studies indicate that, in 2003, Florida's losses from E-Commerce, from other remote sales, and from greater consumption of services, when added to its legislated exemptions, represent the biggest revenue loss sustained in that year by any of the 45 sales-taxing states, as a per cent of total tax collections. Also, by 2004, Florida's loss in estate tax revenues is estimated to approach \$500 million, and to double that amount by 2006.

- Florida's dependence upon sales and use tax revenues, in 1998, for example, was exceeded only by that of two states Washington and Tennessee. Like Florida, both of those states do not tax personal incomes, but, unlike Florida, neither is expressly prohibited in its own constitution from taxing them<sup>2</sup>.

- Congress' recent repeal of federal estate taxation over the next 10 years and its accelerated phase-out

of the estate tax credit for similar taxes paid to the states now forces Florida either to abandon estate taxation as a source of state revenue, or to revise its constitution if it can.

- In 1992, in the *Quill Corporation* case, the U.S. Supreme Court reaffirmed the principle that a vendor whose only contact with a sales-taxing state is through a common carrier or the United States mails cannot be required to collect and remit that state's use tax from its customers residing in that State.
- When decided in 1992, the impact of the *Quill* decision on the States was substantially limited to "remote sellers" selling products by direct mail. But within four years, the commercialization of the Internet had created a new and rapidly growing class of beneficiaries of the *Quill* doctrine: the Internet vendor.
- Current estimates are that one-third of our \$8 trillion national economy could be conducted electronically over the course of this decade, with a major adverse effect on state sales and use tax revenues, assuming continued vitality of the *Quill* doctrine.
- In the last 30 years, the purchase of services has risen from about 45 percent of personal expenditures to nearly 60 percent--a relative increase of one-third in generally non-taxable expenditures. Currently, sales and use taxes are said by some to be a relic of the depression era, applying almost exclusively to sales of tangible property.
- Although a roll-back of the *Quill* doctrine is within the power of Congress, businesses engaged in E-commerce resist such federal intervention, contending that they cannot continue to bear the substantial administrative burden of collecting and remitting the states' use taxes.
- The states acknowledge that collecting and remitting use taxes has become excessively burdensome to business, but they contend that modern technology enables the states to reduce dramatically that burden by streamlining collection and administration of the tax. They have initiated a multi-state coalition--the Streamlined Sales Tax Project-- to accomplish precisely that result, through voluntary reciprocal state action.
- Florida, by enacting the Simplified Sales and Use Tax Administration Act this year, joins the Streamlined Sales Tax Project. In doing so, it takes an important first step toward tax reform in Florida.

Floridians must carefully examine whether more needs to be done. If so, a strategic restructuring of Florida's tax policies needs to be examined as an alternative to the disjointed incrementalism of the past.

### **Introduction**

Among the tax measures enacted when Governor Bush signed H.B.21 into law on June 13, 2001 was the Simplified Sales and Use Tax Administration Act (hereinafter the "Act").<sup>3</sup> This legislation effectively

places Florida in the multistate discussions known as the Streamlined Sales Tax Project (hereinafter "SSTP"). The SSTP is a multistate project controlled by its participating states. Its purpose and objective are to design and establish, through state legislation, a voluntary, streamlined multistate system for the administration and collection of state and local government sales and use taxes. The project's primary design objective is to reduce the complexity and administrative burden currently borne by businesses in collecting use taxes in interstate transactions. After normalizing that burden on interstate businesses, the project's secondary objective is to secure the passage of federal legislation whereby Congress, acting under its Commerce Clause powers, would authorize the states participating in that streamlined tax system to require remote vendors<sup>4</sup> to collect and remit use taxes imposed by those states and their constituent local governments. By authorizing such state laws, the federal law would override the "bright line" rule<sup>5</sup> sustained by the U.S. Supreme Court in *Quill Corporation v. North Dakota*.<sup>6</sup>

While the Act effects no immediate change in the substantive tax laws of Florida, it places Florida in multistate discussions which could result in far-reaching changes in the way sales and use taxes are collected nationally, and in Florida. For this reason, and also because these multistate actions are intended to encourage Congress to restructure the *Quill* doctrine, Florida's opinion leaders should maintain an awareness of the Streamlined Sales Tax Project, and monitor its progress and Florida's involvement in it.

Because the SSTP is an ongoing project and far from completed, the limited purpose of this article will be to identify the project in context with the problems it has been established to resolve. The author will also discuss broadly the involvement of Congress to-date, as it searches for its proper role in context with these developments in the state taxation of E-Commerce and other remote sales. A follow-up article will focus more on the project's achievements and unresolved issues of the SSTP, and the uniform legislation and multistate agreements it produces.

### **Background: Compliance Experience with the Use Tax in Interstate Transactions**

The sales tax was conceived during the depression years, when personal incomes were in decline and most states had few other sources to turn to for revenues. Mississippi first enacted the tax in 1932. By 1938, 26 states had enacted it. Florida enacted the retail sales tax in 1949. Today, 45 states impose the tax, as do nearly 7,600 local governments in 34 states.

The sales and the use tax are two separate taxes which are imposed at the same rate and are said to "complement" each other. Generally, the sales tax is levied on the privilege of selling at retail.<sup>7</sup> It is imposed on the vendor and required by law to be collected by the vendor,<sup>8</sup> from the purchaser, at the point of sale. The use tax is imposed on the privilege of using, consuming or storing tangible property in the taxing state.<sup>9</sup> It is levied on the purchaser but required by law to be collected and remitted by the vendor at the point of sale.<sup>10</sup> Conceptually, the use tax is said to "complement" the sales tax by eliminating the tax incentive to the in-state purchaser to cross the state border and make an otherwise nontaxable retail purchase. Thus, local merchants are not placed unfairly at a competitive disadvantage

because of the state's lack of power to impose its sales tax extraterritorially on the neighboring state's vendor. By requiring the out-of-state vendor to collect and remit the state's own use tax, the sales and complementary use tax of a state are conceived to impact the marketplace in a neutral manner.

From a compliance perspective, interstate sales reveal a principal weakness in the use tax.<sup>11</sup>

While compliance experience with the sales tax varies among states, typically depending upon the quality of the state audit program, most states experience an acceptable level of compliance. In contrast, use tax compliance varies widely, based principally upon the "nexus" criteria of the vendor whereby, as discussed in the next section, a connection may be established by the courts between a state and that which it seeks to tax.

Since the earliest days of the use tax, vendors have preferred to avoid the collection and remittance duties imposed upon them under use tax statutes. A long line of litigated cases reflect efforts of vendors to avoid those duties, usually on the basis that their contacts with the taxing state are insufficient to support constitutionally the states' imposition and enforcement of those burdens upon them.<sup>12</sup> Since 1967, the U.S. Supreme Court has determined that an out-of-state vendor, whose sole contact with the taxing state is through the U.S. mails or common carrier, may not be required by that state to collect and remit its use tax.<sup>13</sup>

Although each state's use tax is imposed upon the consumer,<sup>14</sup> purchaser compliance with the use tax, where for any reason the vendor fails to collect the tax at source, has always been very low.<sup>15</sup> The problem to which the Streamlined Sales Tax Project is directed is this: Interstate sales, involving, from the taxing state's perspective, remote vendors,<sup>16</sup> are growing at a more rapid rate than overall retail sales. That ratio and the problematic compliance experience associated with it is expected to continue into the foreseeable future,<sup>17</sup> representing a continuing erosion of the sales/use tax base of the states.

### ***Quill Corporation v. North Dakota***

In *Quill Corporation v. North Dakota*<sup>18</sup> the issue was whether North Dakota could constitutionally require *Quill*, against Due Process and Commerce clause attacks on its use tax statute, to collect and remit North Dakota's use tax from its direct mail customers in North Dakota. The North Dakota Supreme Court had upheld the state's use tax, and had enforced its vendor collection provisions against *Quill*, refusing to follow the U.S. Supreme Court's 1967 decision otherwise on point in the *National Bellas Hess* case.<sup>19</sup> In deciding *Quill*, the U.S. Supreme Court overturned the Due Process holding in *Bellas Hess*, to the extent it had held that the Due Process clause requires the vendor's physical presence in the taxing state in order to support the imposition of a use tax collection duty. The Court held that evidence of the "purposeful direction" by *Quill* of its substantial marketing activities at North Dakota residents confirmed contact with North Dakota "more than sufficient" to justify the exactions of its use tax from *Quill* under Due Process standards. However, so far as concerned *Quill's* Commerce Clause claims, the Court disagreed with the North Dakota Court's conclusion that it should renounce its Commerce Clause holding in *Bellas Hess*; and it declined to do so, retaining it instead, as its holding in *Quill* under the Commerce

Clause.

The Court's clearest departure from *Bellas Hess* was in the bifurcation of its analysis under the Due Process and Commerce Clauses. While in *Bellas Hess* the Court had dealt with the Due Process and Commerce Clause claims nearly indistinguishably, the *Quill* Court held that those provisions raise two distinct limits on the taxing power of states, which require separate analysis. In the perspective of its importance to both federalism and the national economy, the most significant feature of the *Quill* decision is in the Court's "sculpting" of the holding so that this issue could effectively be regulated by Congress in the future. By lifting the Due Process bar to state enforcement of its use tax against interstate vendors who "purposefully avail" themselves of the taxing of state's markets, even without physical presence in the state, the Court has knowingly<sup>20</sup> placed Congress in a position to override the Court's Commerce Clause ruling, or to allow it to stand, as it sees fit. This feature of the *Quill* decision provides the constitutional basis for currently proposed federal legislation<sup>21</sup> in which Congress would consider allowing certain states, upon meeting Congressionally specified conditions, to require remote vendors to collect and remit the state's use tax.

From the same proposed federal legislation, it is clear that the minimum condition which Congress would impose upon its willingness to modify the *Quill* rule, is the radical simplification of the sales and use tax, and a substantial lightening of its administrative and financial burden on business corporations.

Clearly, the leadership of the major state government and tax associations<sup>22</sup> believes that (i) the states, if willing to act in concert, have sufficient technology at their disposal to "streamline" sales and use tax administration and to make collection responsibility easier for businesses to bear; and (ii) under those changed conditions, a three-way "deal" can be made between business, the states and Congress, which would restore the tax base lost to the states under the *Quill* decision. It is those state tax and political leadership organizations, and, of course, their constituent states that have sponsored and staffed the "Streamlined Sales Tax Project."

### **Why Simplify the Sales and Use Tax?**

To their credit, some state leaders argue in favor of simplifying sales and use tax administration solely on the bases that (i) the technology is available, and (ii) the need of businesses for relief from its excessive compliance burdens is just. The more pragmatic view, however, is that the states would never go to the extreme of conforming their taxing policies to a single model solely in the interest of dealing fairly with business. Indeed, the motivations underlying the Streamlined Sales Tax Project are concerned more with replacing revenues lost to the states in the aftermath of *Quill*, and of even greater amounts projected to be lost in the near future if the *Quill* doctrine should survive without modification.

### ***Quill* in a National Economic Perspective**

When *National Bellas Hess* was decided in 1967, it was generally expected that it would have little impact beyond the "mail order" industry, which at that time was a fledgling industry doing about \$2

billion in gross sales nationally. According to the North Dakota Supreme Court, however, by 1989, the mail-order industry had become a "goliath," with national annual sales that reached "the staggering figure of \$183.3 billion."<sup>23</sup> With revenues corresponding to sales of that magnitude being lost by state and local governments due to *Quill's* modified reaffirmance of *National Bellas Hess*, state legislators took note of *Quill*, but by no means expressed alarm over its implications to future state budgets. It was not until 1996 that tax professionals, in business and in government service as well, realized that *Quill* would have a far greater revenue impact on the states than had been foreseen when the decision was handed down in mid-1992. The reason: the commercialization of the Internet had become a reality during that short span of time; and it became clear that in the borderless environs of cyberspace, Internet vendors could easily avoid "physical presence" in the states in which their products were sold and delivered. In a word, E-Commerce vendors could use *Quill* to avoid most, if not all, of their obligations to collect and remit use taxes for the states and localities into which they sold and delivered their products.

By the end of 1996, the National Tax Association (NTA) held a meeting in Boston to discuss the tax and public finance ramifications of developments in E-Commerce in the aftermath of *Quill*. The participants at that meeting agreed that there were serious potential problems that needed to be further explored. Early in 1997, the NTA established a national project, with a steering committee of tax specialists representing business and government.<sup>24</sup> Meanwhile, in order to "buy" time to study the problem itself, Congress enacted the Internet Tax Freedom Act<sup>25</sup> in 1998, which established a three-year moratorium on certain state taxation of the Internet and E-Commerce<sup>26</sup> and created the Advisory Commission on Electronic Commerce (ACEC) to make a tax study and report to Congress in 18 months. The ACEC filed its report in April 2000.<sup>27</sup>

Both the NTA project report and the ACEC's written report confirmed that the *Quill* decision, and the rapid proliferation of "remote sales" across the country, threatened major erosion to the sales/use tax base of all states and local governments. Both reports also confirmed widespread divergence of views between business and among government leaders, as to what type of compromise tax policy could command a consensus among the states and business associations. Though their work would form an important base from which subsequent efforts would proceed, neither the NTA nor the ACEC reports claimed the reaching of a consensus on any of the critical issues under examination.

During 2000, the country began to see results from the first scholarly efforts to estimate the revenue impact to the states of the post-*Quill* development of E-Commerce.<sup>28</sup> Most of them agreed that their estimates were little more than educated guesses, largely due to the absence of reliable data. The United States General Accounting Office went further in disclaiming any pretense of achieving accurate revenue impact predictions. The GAO decried not only the lack of reliable current data, but the unreliability of confirmed current data as a basis for future projections:

" 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."<sup>29</sup>

Two studies focused particularly on projections for the calendar year 2003. One of those, by University of Tennessee economics professors,<sup>30</sup> Donald Bruce and William F. Fox, concluded that all "remote sales"<sup>31</sup> had been expanding during recent years, and that *Quill* had created a major tax shelter for mail order and Internet vendors. For the 45 states (and District of Columbia) that levy sales and use taxes, the report projects new losses in sales and use tax revenues, sustained from E-Commerce alone during the year 2003, totaling \$10.8 billion.<sup>32</sup> The Tennessee report also made state-specific revenue projections; and it projected that Florida's new state and local sales and use tax revenue losses from E-Commerce alone, for the year 2003, would be \$753.6 million.<sup>33</sup> In a later sequel report, the author calculated the direct local government revenue loss in Florida as 3.02% of that number, leaving the state's incremental loss, or 96.98%, at \$730.84 million.<sup>34</sup>

The *Bruce/Fox Report* then separated each state-specific loss for 2003 between revenues each state would lose and those that its local governments would lose. It expressed those losses as a percent of total tax collections. For the year of 2003 alone, Florida's new state government losses from E-Commerce are projected as 2.49%<sup>35</sup> of its total state tax collections. While that number is significant, what seems more significant is that, according to their report, if one includes Florida's total (incremental and pre-existing) E-Commerce losses as well as trend losses from other remote sales, legislated exemptions and greater consumption of services, then such state revenue losses for 2003 (as a percent of Florida's total state tax collections) would be the highest of all of the 45 states (and D.C.) imposing sales and use taxes.

Senators Bob Graham (D.-Fla.) and George Voinovich (R.-Ohio)<sup>36</sup> called upon the U.S. General Accounting Office (GAO) to make a study of the revenue impact of E-Commerce on the sales and use tax collections of the states.<sup>37</sup> The GAO report, published on June 30, 2000, complained of insufficient reliable data available on which to base even current estimates, let alone future projections. Nevertheless, the GAO came out with "high scenario" estimates and "low scenario" estimates, to describe a range of numbers within which the states' revenue losses might fall.

For the year 2003, whereas the Tennessee Report had predicted 45 state (and D.C.) new revenue sales/use tax losses from E-Commerce alone of \$10.8 billion, the GAO predicted losses between \$1 billion and \$12.4 billion (average \$5.7 billion). However, the GAO's report indicated that losses in 2003 from all remote sales were between \$2.5 billion and \$20.4 billion (averaging \$11.45 billion). On a state-specific basis, the GAO estimated Florida's 2003 E-Commerce-related sales and use tax revenue losses at between \$48 million and \$595 million. It estimated Florida's 2003 losses from all remote sales at between \$321 million and \$1.3 billion

### **The National Debate Intensifies**

By January of 2000, the outlines of a three-cornered national debate over the state taxation of E-Commerce were becoming well-defined.<sup>38</sup> During 2000, legislative initiatives were launched by the states and in Congress to "head off" the catastrophic state revenue losses predicted by the studies. During that year and throughout 2001 to date, the positions of the parties to the debate were clear:

1. Remote vendors the direct mail industry and Internet vendors resist collecting and remitting the 45 states' use taxes because of the grievous administrative burden and the high costs associated with compliance.<sup>39</sup> Companies selling to a national market have to deal not only with the use taxes of 45 states (only 27 of which pay vendor compensation for collection efforts<sup>40</sup>), but with approximately 7,600 use tax-collecting local governments as well. Substantial reductions of the administrative and economic burdens of collecting the tax is their minimum demand. These demands include simplification of the tax and fair compensation for their collection activities and risks.

2. The states' position vis-...-vis the *Quill* decision is clear: they cannot sustain the substantial adverse revenue impact of *Quill* as E-Commerce rapidly gains momentum in the United States. The National Governor's Association (NGA), National Conference of State Legislatures (NCSL), the Multistate Tax Commission and the Federation of Tax Administrators have acknowledged that the burdens and complexity of sales and use taxation in America have become too complex; that modern technology provides opportunities to reduce those burdens substantially, through voluntary cooperative efforts of the states; and all of those organizations have urged the states to support such efforts. Specifically, these organizations have established the Streamlined Sales Tax Project (SSTP), now in its second year of existence.

In December 1999, the National Conference of State Legislatures (NCSL) and the National Governor's Association (NGA) called for a multistate project to develop a "Streamlined Sales and Use Tax System for the 21st century." In January 2000, the NCSL's Executive Committee Task Force on State and Local Taxation of Telecommunications and Electronic Commerce ("NCSL Task Force") approved model legislation. The purpose of the model legislation was for each state to appoint the appropriate authority to participate in discussions with other states to develop the specifics of a voluntary, streamlined multistate system for sales and use tax collections and administration. The central premises to be pursued as goals of the proposed project included a commitment that "remote sellers" should not receive "preferential tax treatment" at the expense of local merchants nor be burdened with discriminatory or multiple taxes.

During 2000, 32 states joined and became participating states either through enacting the NCSL model legislation or by Executive Order of its Governor.<sup>41</sup> The SSTP met throughout 2000 and in November approved and proposed a model act and an agreement (the "SSTP Act and Agreement"). For many reasons, the details of which are outside the scope of this paper, the NCSL Task Force and Executive Committee amended the Model Act and Agreement (the "NCSL Amendment") to include, among other changes, a new and liberalized concept for governance<sup>42</sup> of the Project through July 1, 2003.

Under the SSTP Act and Agreement, the SSTP would maintain control of the terms of the agreement until 5 states had complied (i.e., conformed their laws) with all the simplification requirements, after which these conforming states would control all further amendments to the agreement.

Under the governance provisions of the NCSL Amendment, any state which either enacted the act and statute to comply with the full agreement ("SSTP Package") or just the 10 sections of the act ("NCSL Package"), would, until July 1, 2003, be entitled to participate in multistate discussions and to vote to

amend the Streamlined Sales and Use Tax Agreement. Until that date, the Agreement could be amended by a simple majority of those states. After July 1, 2003, only those states having enacted the Simplified Sales and Use Tax Administration Act and having complied with the Agreement would have authority to amend the Agreement.

During 2001, the state legislatures were presented with alternatives of enacting the "SSTP Package" or the "NCSL Package" in order to enter the Project. The NCSL amendment was relied upon by Florida, which, in H.B. 21, enacted the first 10 sections of the Simplified Sales and Use Tax Administration Act into law.

On May 4, 2001, the four organizations which sponsored the SSTP<sup>43</sup> jointly agreed to, and proposed, seven principles that should guide the states in the next phase of the Streamlined Project. The seven points reflect the NCSL governance concept, whereunder the states that have enacted either the SSTP Package or the NCSL Package will be "Governing States" through July 1, 2003. After that date, the Project and further amendments will be controlled by those states which have conformed their sales and use tax laws to the Agreement.

As of this writing, 17 states,<sup>44</sup> including Florida,<sup>45</sup> are considered "Governing States" of the Project, though 33 states are considered "Participating States" with 6 as formal "Observers." All of these states perhaps with the exception of the Observers have signaled their commitment to work cooperatively toward sales and use tax simplification and to reduce the burdens of use tax compliance upon remote vendors by conforming their sales and use tax laws to norms to be adopted by voluntary reciprocal state action.

**3.** Within the Congress, there is substantial interest in this debate; and apparently, a willingness to act to resolve it. While at present several bills are pending, reflecting opposing views competing for support, one of those bills, Senate 512, seems to have greater support in the Senate than others.<sup>46</sup> This bill, called the "Internet Tax Moratorium and Equity Act," was introduced on March 9, 2001 by North Dakota Senator Byron Dorgan, for himself and for co-sponsoring Senators Enzi, Graham, Voinovich, Breaux, Thomas, Dirkin, Chafee, Lincoln, Hutchison and Rockefeller.

Senate 512 (i) would extend the moratorium of the Internet Tax Freedom Act through 2005; (ii) would encourage the states and localities to work together to develop a "streamlined sales and use tax system" that addresses 13 stated principles "in the context of remote sales," which system Congress finds (in the "sense of Congress") will not, if enacted, violate the Commerce Clause of the Constitution; (iii) would encourage the collaboration of state and local governments and the business community in commissioning a study to determine the cost to sellers of collecting and remitting state and local sales and use taxes, for use in determining what constitutes reasonable compensation; (iv) would authorize the states to enter into an Interstate Sales and Use Tax Compact, which Congress (subject to its reserved authority to reject the Compact within 120 days after submission by the signatory states) consents to generally; and which Compact adopts a streamlined sales and use tax system reflecting the 13 principles stated in the Act; (v) would require the submission of the Compact to Congress for its negative consent

upon the 20th state becoming a signatory to the Compact, on the basis that the Compact will stand consented to by Congress unless Congress disapproves the Compact within 120 days after such transmittal; and (vi) would authorize any state that has adopted the system described in the Compact to require sellers to collect and remit sales and use taxes on remote sales to purchasers located in such state.

Since the three-year moratorium enacted in the Internet Tax Freedom Act expires in October 2001, it is nearly certain that Congress will pass legislation on that subject this year. What is not certain at the time of this writing is whether comprehensive legislation can be agreed on that will combine the moratorium issues and the E-Commerce issues dealt with in Senate 512. Most observers feel that chances are fairly good that compromises can be reached this year; but debate on the issues is intense, and the outcome is far from certain. There is always a possibility that federal legislation enacted this year could be limited in its scope to issues pertaining to the moratorium. If this should happen, S.512 would probably lose momentum in Congress.

### **Conclusion: The Streamlined Sales Tax Project in Context with Florida's Need to Repair its Sales and use Tax System**

In this report, the author has tried to acquaint the reader with the Streamlined Sales Tax Project from the perspective of a "look back" at its roots in the recent history of sales and use taxation. Limitations of space have precluded an explanation of (i) details of the many unresolved debates being carried on within the Project, and (ii) the work accomplished during the first year of the Project, including its Pilot Program.

During the first year of the multistate discussions, Florida was listed neither as an active participant nor as an observer state in the Streamlined Sales Tax Project. However, after its first year, two alternate methods were offered for new states to join the Project. With Florida's enactment of the Simplified Sales and Use Tax Administration Act ( § 5, 6, and 7 of H.B.21), it now becomes a full participant in the Project.

As Florida's legislative leaders consider the need for reform of the state's tax system, nothing is more important in this author's view than for Florida to attend to the ongoing processes of erosion of its sales and use tax base. As noted in the GAO Report, the extent to which Florida relies on sales and use tax revenues to pay for the cost of government is exceeded by only two other states in the Union.<sup>47</sup> Of the six states having the highest level of reliance on sales tax revenues for public funding, none of them, as a matter of policy, taxes personal incomes (There are only seven such states in the U.S.). However, of those six states, only Florida has expressly prohibited the state taxation of personal incomes in its constitution. Thus, Florida's reliance on the long term vitality of its sales and use tax system is probably unique among all the United States.

Even so, there is evidence that Florida's sales and use tax base is suffering a major and ongoing erosive impact (i) from direct e-mail, E-commerce and *Quill*, (ii) from a substantial swing, during the last two or three decades, to a service economy, and (iii) from widespread exemptions. The entry of Florida into the

Streamlined Sales Tax Project is a strong start in the direction of reforming the administrative side of the sales and use tax, which in turn will hopefully lead to Congress' assistance in restoring the use tax base lost from the growth of remote sales especially through direct mail and E- Commerce in the aftermath of *Quill*. Florida should commit its full prestige and power to the success of the Project, as well as to the enactment of Senate 512.

If S.512 is enacted, and the Project leads to a multistate tax compact consented to by Congress, the substantial sales/use tax revenue losses currently predicted for Florida for 2003 may possibly be averted, depending upon how fast those goals can be achieved. At the very least, the hemorrhage resulting from the future proliferation of untaxed remote sales will be stopped.

Other major revenue leaks in Florida's sales/use tax structure will also need the serious attention of Florida's legislative leaders. Some politically difficult questions need to be asked and answered. For example, Florida had a short, unpleasant and unsuccessful experience attempting to tax services, which ended in 1987. However, the "tilt" of the U.S. economy toward consumption of services has continued since then, with dilutive impact on sales tax bases throughout the country, including Florida. The Florida legislature should commission a study to project the current and future revenue implications of this major change in the economic environment.<sup>48</sup> Only by putting the economic facts on the table can Florida make the correct choices concerning the need for strategic and structural repairs to its sales and use tax system.

The policy implications of such a re-evaluation of Florida's sales and use tax base must necessarily be judged in the light of all contemporary developments having material budgetary impact on Florida, obviously including Congress' recent repeal of the federal estate and gift tax. While the federal tax itself is phasing out over a 10-year period, to be completed in 2011, the phase-out of the federal credit<sup>49</sup> for estate taxes paid to state governments will be accelerated ahead of the federal repeal schedule. The phase-out of the federal credit will trigger a shutdown of Florida's estate tax, which is itself constitutionally limited to the federal credit.<sup>50</sup> As reported in May, by Florida TaxWatch<sup>51</sup> the most current Department of Revenue revenue estimates showed a substantial impact from estate tax repeal on Florida's General Revenues, beginning with fiscal year ending 2003:

<b>Revenue Impacts (in \$millions) of Estate Tax Phase-out in Florida</b>			
F/Y/E 2003	F/Y/E/2004	F/Y/E 2005	F/Y/E 2006
(174.3)	(488.3)	(808.7	1,124.1

The objectives of the Streamlined Sales Tax Project are worthy of all the efforts being expended to achieve them. The use tax has become excessively complex and burdensome to America's businesses, which have too long carried the burden of its administration without adequate efforts by the states to compensate them fairly for their costs of compliance or to use modern technology and effective management practices to lighten that burden.

Beyond that, since it seems unquestionable that Florida has a special vulnerability to the *Quill* decision,

Senator Bob Graham is to be commended for his co-sponsorship of Senate 512 and should be encouraged and assisted in his efforts to win its early passage. In short, Florida's officials at all levels should commit Florida's full prestige to the objectives of the Streamlined Project and to the objectives of Senate 512.

*[In the next Special Report in this series, the author will focus on the activities and achievements of the Streamlined Sales Tax Project and related developments in Congress.]*

---

## ENDNOTES

1. *Sales Taxes: A Report to Congressional Requesters*, U.S. General Accounting Office (GAO/GGD/OCE-00- 165 June, 2000), Appendix IV, Table IV.1, pages 56, 57. [hereinafter *GAO Report*].
2. In reality, the constitutional difference between Washington and Florida is probably not great. Washington's Supreme Court still adheres to its 1933 opinion in *Culliton et al. v. Chase et al.*, 25 P.2d 81 (Wash.-1933), holding a graduated income tax to be a "property tax" within the meaning of that term in the state's constitution, and thus subject to and in violation of the uniformity rule. In Tennessee, the constitutionality of a state personal income tax is considered to be fairly debatable. See *Evans et al. v. McCabe*, 52 S.W. 2d 159 Tennessee Sup. Ct.-1932; *Jack Cole v. MacFarland* 337 S.W. 2d 453 (Tennessee Sup. Ct.-1960); *Lawrence v. MacFarland et al.* 354 S.W.2d 78 (Tennessee Sup. Ct.-1962); Cf., Tenn. Atty. Gen. Op. 99-217, 10/28/1999, concluding that the Tennessee General Assembly does have the power to levy a state personal income tax.
3. § 5, 6 and 7, H.B. 21.
4. We adopt as our definition of "remote vendor" the "seller" in a "remote sale" as the latter is defined in S.512, § 9(3). "The term 'remote sale' means a sale in interstate commerce of goods or services attributed, under the rules established pursuant to section 4(a)(3), to a particular taxing jurisdiction that could not, except for the authority granted by this Act, require that the seller of such goods or services collect and remit sales or use taxes on such sale." S.512 introduced principally by Sen. Byron L. Dorgan, D-N.D., is a bill that would combine a four-year extension of the current Internet Tax Freedom Act moratorium on Internet access taxes and multiple and discriminatory taxes with provisions for states to create an interstate sales and use tax compact, and a Congressional override of the *Quill* decision.
5. The "bright line" rule of the *Quill* decision is that under the Commerce Clause (Article I, § 8, cl.3) of the Federal constitution, a state (call it the "Taxing State") may not require an out-of-state vendor, whose sole contact with, or "presence" in, the Taxing State is through a common carrier or the U.S. Mails, to collect (and remit) the Taxing State's sales or use tax from the vendor's customers residing in that state. See our further discussion of the *Quill* case on page 7 *et seq.*
6. 504 U.S. 298, 112 S.Ct. 1904 (1992).
7. Fla. Stat. § 212.05 (2000).
8. Fla. Stat. § 212.06(1)(a), 212.06(3)(a) (2000).

9. Fla. Stat. § 212.05 (2000).
10. Fla. Stat. § 212.06(3)(a) (2000).
11. John F. Due and John L. Mikesell, *Sales Taxation: State and Local Structure and Administration*, p. 322 (The Urban Institute Press, 2d ed. 1994).
12. For the progression of major cases decided prior to 1967 by the U.S. Supreme Court, in which vendors sought to escape those responsibilities based upon claims that they violated the Due Process and Commerce Clauses of the federal constitution, see *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62, 59 S.Ct. 376 (1939); *Nelson v. Sears Roebuck & Co.*, 312 U.S. 359, 61 S.Ct. 586 (1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373, 61 S.Ct. 593 (1941); *General Trading Co. v. State Tax Comm'r. of Iowa*, 322 U.S. 335, 64 S.Ct. 1028 (1944); *Scripto Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619 (1960).
13. See *National Bellas Hess, Inc. v. Dept. of Rev. of Illinois*, 386 U.S. 753, 87 S.Ct. 1389 (1967); see also *Quill Corporation*, 504 U.S. 298.
14. See, e.g., Fla. Stat. § 212.06(3)(a) (2000).
15. It must be remembered that the release of the vendor, under constitutional principles, from its duty to collect and remit the use tax still leaves the purchaser personally liable for its reporting and payment [Fla. Stat. § 212.07(8) (2000)]. While some purchasers claim a lack of awareness of their liability, their failure to report and pay the tax is generally regarded as the most serious form of compliance problem: that is, evasion.
16. See *supra* note 3.
17. Due and Mikesell, *supra* note 9, at 322.
18. 504 U.S. 298.
19. *North Dakota v. Quill Corporation*, 470 N.W. 2d 203, 219 (N.D. 1991). In *National Bellas Hess*, the U.S. Supreme Court had held that a similar Illinois use tax statute both violated the Due Process clauses of the Fourteenth Amendment, and had placed an unconstitutional burden on interstate commerce. Its holding established the "bright line" rule that "a seller whose only connection with customers in the taxing state is by common carrier or the United States Mail lacks the requisite minimum contacts with the state." The North Dakota Court refused to follow *Bellas Hess* because it believed "the tremendous social, economic, commercial and legal innovations" of the past quarter century had rendered its holding "obsolete."
20. "Accordingly, Congress is now free to decide whether, when, and to what extent the states may burden interstate mail-order concerns with a duty to collect use taxes." *Quill Corporation*, 504 U.S. at 318.
21. See *infra* note 44.
22. Referring principally to: National Conference of State Legislatures (NCSL), National Governors Association (NGA), Multistate Tax Commission (MTC), and the Federation of Tax Administrators (FTA).

23. *North Dakota v. Quill Corporation*, 470 N.W.2d at 209.
24. NTA Communications and Electronic Commerce Tax Project. The Steering Committee met nine times between September 1997 and July 1999, and issued a written report on September 7, 1999 (which can be accessed at [http://www.ntanet.org/ecommerce/Final\\_report\\_cover.htm](http://www.ntanet.org/ecommerce/Final_report_cover.htm)).
25. 47 U.S.C.A. § 151 (West 2000), Pub. L. 105-277, Div. C, Title XI, §§ 1100-1104, Oct. 21, 1998, 112 Stat. 2781-719.
26. including taxation on "access" to the Internet and "of multiple or discriminatory taxes on electronic commerce."
27. The Commission reached the Congressionally mandated two-thirds consensus on only three of the many issues that it considered.
28. See generally *GAO Report*; Donald Bruce and William F. Fox, "E-Commerce in the Context of Declining State Sales Tax Bases," *National Tax Journal*, Vol. 53, No. 4, Part 3, pp.1373-1388, 2000 [hereinafter *Bruce/Fox Report*]; 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); Austin Goolsbee and Jonathan Zittrain, "Evaluating the Costs and Benefits of Taxing Internet Commerce," *National Tax Journal*, 52(3), Sept. 1999, pp. 413-28.
29. *GAO Report*, *supra* note 21, at 4.
30. *Bruce/Fox Report*, *supra* note 26.
31. The authors include within the definition of "remote sales" E-Commerce and catalog sales, and cross-border shopping.
32. Our further reference to the 45 sales taxing states should be understood to include the District of Columbia. Also, \$10.8 billion represents only the new, or the incremental revenue loss in 2003 from E-Commerce. The total E-Commerce loss, which also includes pre-existing losses, is \$20.1 billion.
33. This figure represents the new, or incremental loss in Florida (state and local governments) for 2003. The total E-Commerce loss adds to this any purchases that, prior to the development of E-Commerce, would still not have resulted in any tax being collected, for example: a shift from a "tax free" catalog or Internet sale. Florida's total E-Commerce loss for 2003 would be \$1,403.0 million.
34. Donald Bruce and William F. Fox, "E-Commerce and Local Finance: Estimates of Direct and Indirect Sales Tax Losses," *University of Tennessee*, 21, 24 (Oct. 2000).
35. The percentage applicable to total E-Commerce losses to Florida in 2003 is 5.83%.
36. Both Senators are co-sponsors of S.512: "Internet Tax Moratorium and Equity Act," introduced by North Dakota Senator Byron Dorgan. See reference on p. 3.
37. *GAO Report*, *supra* note 1.

38. Though the debate currently focuses on sales and use taxation, there are indications that it will spread to business activity taxes as well.
39. Many members of this group would resist any Congressional override of *Quill* to grant expanded authority to the states to tax E-Commerce, even if the use tax were radically streamlined by the states. Among those are companies wishing to keep the competitive advantage over local merchants resulting from their ability to offer to sell goods without sales or use tax. This does not appear to be a position favored in Congress.
40. Generally, business representatives complain that most paying states offer less than the costs incurred by vendors in collecting the tax.
41. Florida enacted qualifying legislation but elected not to be listed as a participating state in the SSTP during 2000. It is now listed.
42. The NCSL Amendment added Article VII ("Interim Governance") to the Streamlined Sales and Use Tax Agreement.
43. The National Governors Association, National Conference of State Legislatures, Multistate Tax Commission and Federation of Tax Administrators.
44. Arkansas, Florida, Indiana, Kentucky, Louisiana, Maryland, Minnesota, Nebraska, Nevada, North Dakota, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, Utah and Wyoming. A bill has been approved in Illinois, and now awaits action by the governor.
45. H.B. 21 was signed into law by Gov. Bush on June 13, 2001.
46. In addition to S.512, other bills pending on the subject of taxation of E-Commerce include: S.288 (sponsored by Sen. Wyden, D-Ore.), S.589 (sponsored by Sen. Smith, R-N.H.), S.777 (sponsored by Sen. Allen, R-Va.), H.R.1410 (sponsored by Rep. Delahunt, D-Mass.), H.R.1552 and H.R.1675 (sponsored by Rep. Cox, R-Calif.).
47. Florida's sales and use tax revenue (1998) constituted 57.4% of its total tax revenues for the year. Only Washington and Tennessee exceeded Florida's percentage, with 58.5% and 57.6%, respectively. *See GAO Report, supra* note 1, at 56-57.
48. These projections will of course need to be viewed in the light of the very recent repeal of the federal estate tax, and the accelerated phase-out of the credit for estate taxes paid to states.
49. I.R.C. § 2011 (1986).
50. Fla. Const. art. VII, § 5(a).
51. See Keith G. Baker, "Estate Tax Phase-Out a Formidable Challenge to Florida's Budget," *Florida TaxWatch Briefings*, May 2001: access at <http://www.floridatxwatch.org/estatetax2.html>.

## **ABOUT THE AUTHOR**

*Richard H. Hunt is a tax attorney practicing in Miami, Florida. A graduate of Yale University (B.A.), University of Florida College of Law (J.D.), and New York University Graduate School of Law (LL.M. [Taxation]), he concentrates his law practice in the field of state and local taxation. Also, as an Adjunct Professor of Law, he teaches the subject of State and Local Taxation in the Graduate Tax Program at the University of Miami School of Law.*

*A member of Florida TaxWatch's first Executive Committee and its founding corporate secretary in 1979, Mr. Hunt contributes this paper as a member of its Board of Trustees working in close cooperation with its research staff.*

*Mr. Hunt is active as a member of the State and Local Tax Committees of the Tax Sections of the Florida Bar and the American Bar Association. He is a member of the National Tax Association, the International Association of Assessing Officers, and other organizations of tax professionals. He is a frequent lecturer and contributor of articles on subjects related to taxation. He has testified before Florida legislative committees as an expert on matters of state and local taxation.*

*[Mr. Hunt can be reached at: Richard H. Hunt & Associates, P.A., 2801 Ponce de Leon Boulevard, Suite 1140, Coral Gables, Florida 33134, Tel: 305-461-4050; Fax: 305-569-9671 / E-mail: huntmia@ix.netcom.com.]*

---

The *Special Report* was researched and written under the direction of Keith G. Baker, Ph.D., Senior Vice President and Chief Operating Officer. T. O'Neal Douglas, Chairman; Dominic M. Calabro, President and Publisher

**© Copyright Florida TaxWatch, August 2001**

---

To obtain more information regarding this report  
E-Mail:



Return to the [TaxWatch](#) main page.