

NEWS TAKES

States are getting better organized to collect Internet sales taxes, but what does that mean for businesses? An effort by state governments to collect sales taxes on Internet transactions recently moved a step closer to reaching that goal. In late June, 18 states came into compliance with a more uniform sales and use tax system that should make it easier for businesses to collect sales taxes over the Web.

The simplified tax plan is the product of several years work by an alliance of state governments called the Streamlined Sales Tax Project (SSTP). The states that have adopted the streamlined system will now encourage online retailers to voluntarily collect sales taxes, beginning in October, using the new system and software from SSTP-designated vendors. While the effort to collect more sales taxes on online transactions might sound like bad news for businesses, since at least some of the online volume is driven by the absence of sales taxes, the more uniform system being promulgated will at least make compliance by sellers and buyers easier and ultimately less expensive.

More than 7,500 state and local governments in the U.S. collect sales taxes, and many levy different rates on different types of products. Jurisdictions have varied in how they classified products—for example, some states tax marshmallows as candy and others classify them as food. Various exemptions also vary, as do their systems for collecting taxes. Back in 1992, in a case involving a catalog company, the Supreme Court cited the burden that the many different tax regulations and rates would pose for out-of-state sellers and refused to require sellers to collect sales taxes in states where they lacked a physical presence. Of course, the law says that buyers must remit an equivalent tax if sales tax was due on a purchase but not collected by the seller, but compliance is spotty.

As Internet sales grew, states concerned about the potential drain on their sales tax revenues formed the SSTP and worked out what they call the Streamlined Sales and Use Tax Agreement. In time, the group hopes to persuade Congress to make it mandatory for out-of-state sellers to collect sales taxes for all states whose laws conform to the simpler system.

Estimates vary on how much revenue state and local governments lose because sales taxes aren't collected. A University of Tennessee report estimated that uncollected sales taxes totaled \$13 billion in 2001, while a study by the Direct Marketing Association put the 2001 total at \$1.9 billion. In any case, it's likely that the bulk of unpaid sales taxes represent sales to consumers, rather than to businesses. Although few individuals worry about paying use taxes, some estimates put business compliance with use taxes at 85% or even higher. "Businesses are a bit more under the microscope and they tend to be audited," notes Dick Eppleman, director of government markets at Vertex Inc., a Berwyn, Pa.-based provider of tax software.

Eppleman sees the work the states are doing to simplify their sales tax regulations as a big plus for businesses. Simplification will clear up ambiguities and make it easier for companies to comply with sales and use taxes, he says. "The more states that adopt the simplification provisions of the streamlined sales tax, the better it is for large organizations," Eppleman says. "Anything that reduces the complexity of the law reduces the complexity for them." He adds that

the states still have work to do in this area, though, and cites the definition of tangible personal property and its digital equivalents and the treatment of shipping charges as areas where ambiguities remain.

Faranak Naghavi, national director of the sales and use tax practice at Ernst & Young LLP, says that the current situation, in which some retailers voluntarily collect sales taxes and others do not, gives corporations an option. Some may prefer to deal with suppliers that charge sales tax so that they don't have to worry about keeping track of unpaid taxes. On the other hand, a company that's buying an item that may not be subject to tax might prefer to deal with a supplier that doesn't collect taxes so that it doesn't have to worry about providing an exemption certificate, she says.

But Naghavi warns that companies need to take into account the changes that are occurring in state sales tax laws. "A lot of companies fail to see that, they believe that [the changes] only apply to online sellers," she says. "As consumers, when they purchase goods or services subject to tax, any changes in the laws of the states where the purchases are made or the goods or services are used may affect the taxability decision-making process they have to go through. That's one of the biggest implications that companies have to be thinking about and a lot of them are not."

Most of the 18 states that have brought their sales tax systems into compliance with the streamlined system have relatively small populations, like Indiana and South Dakota. Richard Nielsen, who is of counsel to the tax group of law firm Pillsbury Winthrop Shaw Pittman LLP argues that the outlook for the initiative will be "problematic" until the project signs up some of the larger states with more complicated tax systems. But Naghavi says the fact that 18 states have done the work to become members may convince bigger states that it's time for them to get on board. And Diane Hardt, co-chair of the SSTP and tax administrator for the Wisconsin Department of Revenue, calls 18 states "a good start."

"Hopefully that, along with us getting the technology in place, will get the attention of Congress," Hardt says. She expects legislation to be introduced in Congress this year, and adds that brick-and-mortar retailers are supporting the states in their pursuit of federal legislation because they want a level playing field with online sellers. Hardt also notes that while collection will be voluntary, the states are offering amnesties to online sellers, promising not to pursue them for past sales taxes if they sign up to start collecting. Wisconsin has already heard from 30 online retailers interested in participating, she says. "We think a number of the dotcoms related to brick-and-mortar stores might come forward, especially since there are some recent court decisions that suggest they should be collecting," Hardt adds.
