



**Written Testimony of Joseph D. Henchman
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Committee on Ways and Means
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Regarding H.B. 337**

My name is Joseph Henchman, and I am currently Tax Counsel and Director of State Projects at the Tax Foundation, a non-partisan, non-profit research institution founded in 1937 to analyze tax issues and raise economic awareness among taxpayers, lawmakers, and the media. We track tax-related issues at all levels of government, and have followed the Streamlined Sales Tax Project (SSTP) effort closely. I would also note that I am a proud member of the Maryland Bar.

We appreciate the opportunity to submit this written testimony regarding H.B. 337 to the Ways and Means Committee. The Tax Foundation takes no position on the bill, but is eager to provide information about the subject matter. Maryland and other states considering involvement with the Streamlined Sales Tax Project (SSTP) should be fully informed about both the positives and negatives of the project. **The effort has its merits, but it also neither a source of free money nor non-controversial.**

The written testimony which follows is drawn from two papers I have published on the subject. The first, "Why the *Quill* Physical Presence Rule Shouldn't Go the Way of Personal Jurisdiction," was published in the *State Tax Notes* trade publication in November 2007. The second, "Nearly 8,000 Sales Taxes and 2 Fur Taxes: Reasons Why the Streamlined Sales Tax Project Shouldn't Be Quick to Declare Victory," was produced in-house at the Tax Foundation in July 2008. I would also recommend a paper produced by the Council on State Taxation, "'Old Economy' Tax Systems on a 'New Economy' Stage: The Continuing Vitality of the 'Physical Presence' Nexus Requirement," published in February 2003, which reviews the mixed success of the SSTP at that time. The Tax Foundation would be happy to provide copies of these materials.

In 1992, in *Quill Corp. v. North Dakota*, the U.S. Supreme Court reaffirmed that the power of states to impose taxes on interstate commerce is limited by their geographic border. **Although some academics resent this "physical presence rule," it remains the law of the land and is essential to prevent revenue officials from wreaking havoc on national markets by reaching beyond their borders for tax revenues.** Since no working alternative to the physical presence rule has been developed, abandoning it would result in states harming themselves by harming the whole.

The SSTP was formed in reaction to *Quill*, though not necessarily to create an alternative to the physical presence rule. The SSTP is a working group of revenue officials and experts, with the stated purpose of bringing simplicity and uniformity to sales taxes in the United States. (**The governance structure of raises some questions of democratic accountability and whether SSTP receives or seeks genuine public input.**) Member states must adopt reforms to align their tax code with the SSTP. The hope is that simple and uniform sales tax statutes will allow the collection of interstate sales taxes without placing burdens on interstate commerce.

Simplicity and uniformity are both important goals, but the SSTP has at best mixed success in achieving them. There are nearly 8,000 sales taxing jurisdictions in the United States, each with their own bases and rates, and the enormous complexity involved in tracking borders and changes is a huge stumbling block to state efforts to impose tax on online sales.

While the SSTP has made some progress on uniformity (they have succeeded, for instance, in a single accepted definition of "candy"—something everyone defined differently before), **the SSTP appears to be giving up the effort on simplicity.** At their New Orleans meeting in July 2008, for instance, I asked if any effort was being made to reduce the number of sales taxing jurisdictions, and/or to align them with 5-digit zip codes. "No and no," was the short but honest answer.

Rather than requiring that states simplify before reaching out beyond their borders to tax out-of-state companies, the SSTP seems content to let states continue the status quo. One panelist noted that far from requiring substantial reforms, "States still get to do 99.9% of what they want to do" under the SSTP agreement. This demonstrates either disingenuousness or how little the SSTP recognizes that many existing sales taxes are in need of substantial reform.

The SSTP already abandoned the notion of taxing like transactions alike when they adopted "destination sourcing" for online sales, but permitted states to adopt "origin sourcing" for intrastate sales. This in effect requires Internet companies to collect sales taxes based on where their customer is located, but allows brick-and-mortar stores to collect sales taxes based on where the store is located. **In this way, the SSTP prevents a level playing field between Internet business and brick-and-mortar businesses.**

Coupled with the SSTP's non-worry about reducing the number of jurisdictions (they spoke optimistically of providing maps of sales tax jurisdictions, having rejected even aligning jurisdictions with 9-digit zip codes), full implementation of the SSTP at this time, without serious reforms, could result in a serious and inequitable burden on e-commerce.

Another recent example involves clothing taxes. The SSTP requires that all states have a uniform definition of clothing, and tax all of it (or none of it) at the same rate. Minnesota did so, but then imposed a "separate" fur tax on fur sales. Rather than recognizing this as an end-run around tax uniformity, the SSTP upheld Minnesota's action.

The SSTP is attempting to persuade Congress to permit SSTP member states to begin collecting sales taxes on online purchases, premised on the belief that the SSTP's simplification and uniformity mission has been accomplished. **The SSTP has not accomplished its mission.** The SSTP should look again at serious simplification efforts before declaring themselves a success and seeking to expand state taxing power.

States such as Maryland should be willing to adopt uniform definitions worked out by the SSTP, so as to reduce transaction costs between state statutes. However, the ability of Maryland to collect sales tax on online transactions is wholly dependent on the willingness of other states to simplify their laws and adopt uniform definitions as well. It is also dependent on the creation of a working alternative to the physical presence standard that provides certainty and prevents multiple taxation. **Neither the wholesale adoption nationwide of uniform sales tax statutes, nor the development of a working alternative that provides the certainty needed for long-term investment, are likely in the foreseeable future.**

For these reasons, legislators in Maryland and other states should understand that SSTP membership does not lead to a sudden influx of free tax money. In any event, this money will come from Maryland residents, and should be looked at as a tax increase notwithstanding the existing liability under the use tax laws. **The SSTP's goals are good ones, but their success is mixed at best, and whatever effect it has will not be seen in the short-term.**

The Tax Foundation would be happy to provide further information on this or other tax-related subjects at the Committee's request. We thank the Committee for its consideration of our written testimony.

Yours Very Truly,

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