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State and Local Sales and Use Taxes and Internet Commerce

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Summary

In theory, state sales and use taxes are consumption taxes based on the destination principle. The destination principle prescribes that taxes should be paid where the consumption takes place. Sales taxes collected at the point of sale achieve this if consumption takes place near the point of transaction. In contrast, consumers pay a *use* tax on products purchased out-of-state and used in their home state where consumption likely takes place.

Under current law, states cannot reach beyond their borders and compel out-of-state vendors (without nexus in the state) to collect the use tax owed by state residents. The Supreme Court has ruled that requiring remote vendors to collect the use tax would pose an undue burden on interstate commerce. States are concerned because they anticipate gradually losing more tax revenue as the growth of Internet commerce allows more residents to buy products from vendors located out-of-state and evade use taxes. Recent estimates put this loss at approximately $8 billion in 2003. For this report, "Internet taxes" are existing use taxes and taxes on Internet access services. States that rely more heavily on the sales and use tax will likely lose more revenue than states less reliant on the sales and use tax.

Congress is involved in this issue because commerce conducted by parties in different states over the Internet falls under the Commerce Clause of the Constitution. Currently, the "Internet Tax Moratorium" prohibits (1) new taxes on Internet access services, and (2) multiple or discriminatory taxes on Internet commerce. This moratorium was created by the Internet Tax Freedom Act (ITFA) of 1998 and had expired on October 21, 2001. Congress extended the "Internet Tax Moratorium" through November 1, 2003, with P.L. 107-75, enacted on November 28, 2001. The moratorium was extended for an additional four years, through November 1, 2007, by P.L. 108-435, enacted on December 3, 2004. The moratorium is related to the use tax collection issue, but is not the focus of this report.

The degree of further congressional involvement is an open question. Congress could do nothing and end the moratorium and not address the use tax issue. Or, Congress could: (1) extend the moratorium (or make it permanent) and/or (2) address the use tax issue. Opponents of remote vendor use tax collection responsibility would support a permanent moratorium and a clearer definition of nexus for use tax purposes. Many state officials are opposed to a permanent moratorium and would like Congress to change the law and allow states to require out-of-state vendors without nexus to collect state use taxes. Simplification and harmonization of state tax systems are likely prerequisites for Congress to consider approval of increased collection authority for states. This report will be updated as legislative events warrant.

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State and Local Sales and Use Taxes and Internet Commerce

Introduction

State governments rely on sales and use taxes for approximately one-third (33.8%) of their total tax revenue — or approximately $185 billion in FY2003.[1] Local governments derived 11.7% of their tax revenue or $43.3 billion from local sales and use taxes in FY2002.[2] Both state and local sales taxes are collected by vendors at the time of transaction and are levied at a percentage of a product's retail price. Alternatively, use taxes are often not collected by the vendor if the vendor does not have nexus (loosely defined as a physical presence) in the consumer's state. Consumers are required to remit use taxes to their taxing jurisdiction. Compliance with this requirement, however, is quite low. Because of the low compliance, many observers suggest that the expansion of the internet as a means of transacting business across state lines, both from business to consumer (B to C) and from business to business (B to B), threatens to diminish the ability of state and local governments to collect sales and use taxes.

Congress has a role in this issue because commerce between parties in different states conducted over the Internet falls under the Commerce Clause of the Constitution.[3] Congress can either take an active or passive role in the "Internet tax" debate. This report intends to clarify important issues in the Internet tax debate.

Overview

A Brief History of the Sales and Use Tax. In 1932, Mississippi was the first state to impose a general state sales tax.[4] During the remainder of the 1930s, an era characterized by declining revenue from corporate and individual income taxes,

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[1] U.S. Bureau of the Census, "2003 State Government Tax Collections," available online at [http://www.census.gov/govs/www/statetax.html].

[2] U.S. Bureau of the Census, "State and Local Government Finances: 2001-02," available online at [http://www.census.gov/govs/www/estimate.html].

[3] U.S. Constitution, art. 1, sec. 8.

[4] In Mississippi, a *use* tax, the companion to the sales tax, was added in 1938. A use tax is a tax on the use of a product. In the early years of the sales tax, states began with general sales then added the use tax. Eventually, states adopting a sales tax included the use tax in the enacting legislation.

23 other states followed suit and implemented a general sales tax.[5] At the time, the sales tax was relatively easy to administer and could raise a significant amount of revenue with a relatively low rate.[6] Given the relative success of the sales tax in raising revenue, 45 states and the District of Columbia added the sales tax to their tax infrastructure by the late 1960s. The last of the 45 states to enact a general sales and use tax was Vermont in 1969.[7]

What Are "Internet Taxes"? Over the last several years, a number of bills have been introduced in Congress that address "Internet taxes."[8] For this report, and in the majority of the legislation introduced, "Internet taxes" refer to two sub-federal taxes: (1) state sales taxes on Internet access services (sometimes referred to as Internet access taxes) and (2) state sales and use taxes on products and services purchased over the Internet. Internet access taxes, in states where they exist, are typically a sales tax (or gross receipts tax, GRT) on Internet access services.[9] The Internet Tax Freedom Act (ITFA) defines Internet access service as a service "...that enables users to access content, information, electronic mail, or other services offered over the Internet...."[10] The economic burden of an Internet access tax is shared by access providers (such as America Online and Earthlink) and consumers of Internet services.

The most recent extension of the Internet tax moratorium (P.L. 108-435) prohibited Internet access taxes unless they existed before the original passage of the ITFA in October 1998. The extension of the moratorium expires November 1, 2007. A permanent prohibition of Internet access taxes would prevent state and local governments from ever assessing a sales tax (or GRT) on the provision of these services. Some observers have argued that the definition of Internet access should be broadened to ensure that all means of connecting to the Internet — such as through digital subscriber lines (DSL) — are treated equally.

The most recent moratorium extension modified the moratorium to include new taxes on DSL (those not existing before November 1, 2003). Under the original

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[5] Fox, William F., ed., *Sales Taxation: Critical Issues in Policy and Administration*, *Sales Tax Trends and Issues*, by Ebel, Robert and Christopher Zimmerman (Westport, CT: Praeger, 1992), pp. 3-26.

[6] The highest rate in 1934 was 3%, which was considered quite high at the time. Today, in some Oklahoma jurisdictions, the rate can be as high as 9.75%.

[7] The five states without a state sales and use tax are: Alaska, Delaware, Montana, New Hampshire, and Oregon. Alaska allows local jurisdictions to impose a local sales tax.

[8] For a review of Internet related legislation introduced in the 108th Congress, see CRS Report RL31929, *Internet Taxation: Issues and Legislation in the 108th Congress: A Brief Comparison*, by Steven Maguire and Nonna Noto.

[9] A gross receipts tax, such as New Mexico's, is a business tax that is levied on all of the revenues generated by a business operating in the state. The grand-fathering provision in the Internet Tax Freedom Act, allowed states with Internet access taxes in place to keep them. The current list of states with Internet access taxes: New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas (with a $25 exemption), and Wisconsin.

[10] P.L. 105-277, Title XI.

moratorium, telecommunications services, including DSL, were not subject to the moratorium and thus were taxable (although cable Internet access was included in the moratorium). Many states began taxing DSL services and during the debate over the most recent extension (P.L. 108-435), many policymakers proposed including DSL in the moratorium. As a compromise, Congress banned new DSL taxes and allowed states that had already taxed DSL to continue to do so for the life of the moratorium.[11]

The second type of "Internet tax" is the imposition of the sales and use tax on transactions arranged over the Internet. The expanding acceptance of the Internet as an alternative to traditional retail transactions has complicated the collection of this tax. Generally, if a vendor does not have "nexus" (loosely defined as a physical presence) in the buyer's home state, then the vendor is not required to collect the sales or use tax. In these situations — where the vendor does not have nexus — the buyer is required to remit a use tax to his or her state government. In reality, consumer compliance with this requirement is quite low. Thus, contrary to what some observers suggest, Internet purchases are "tax-free" only in the sense that consumers are evading the use tax due on those transactions.[12]

The variation among the state and local governments in the administration of the sales tax is at the center of the Internet tax debate. The U.S. Supreme Court has ruled that the collection of sales taxes by remote vendors would be too burdensome; there are thousands of taxing jurisdictions, each with its own rates and base.[13] In an effort to minimize that administrative burden, many states are working together to simplify and standardize their tax systems in the hope that Congress will grant them the authority to require remote vendors to collect the sales tax. This initiative is identified as the Streamlined Sales Tax Project (SSTP). Simplification of sales and use taxes will be difficult because of the extensive variation among states in the administration of the sales and use tax. An analysis of state and local sales tax systems follows below.

Two Components of the Sales and Use Tax

The revenue that a sales and use tax generates, assuming a given level of compliance, depends upon the chosen rate and the base to which the rate applies. The more narrow the base the higher the rate must be to raise an equivalent amount of revenue. States often have similar consumption items included in their tax base, but they are far from uniform. Tax *rates* can also vary considerably, depending on

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[11] A special provision applying only to Wisconsin extends the grandfather provision for existing DSL taxes in that state through November 1, 2005, not November 1, 2007.

[12] Tax evasion is illegal, whereas tax avoidance, where individuals change their behavior to reduce their tax burden, is legal. For example, moving to a state with no personal income tax, such as Florida, Maine, or Texas, is legal state income tax avoidance. A Florida resident not paying the Florida use tax on an out-of-state purchase is tax evasion.

[13] Two decisions shape the current legal status of remote collection: *National Bellas Hess, Inc. v. Department of Revenue State of Illinois*, 386 U.S. 753 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

the state's reliance on other revenue sources. The SSTP is intended to create a more uniform sales tax system among participating states.

The SSTP would establish a system where states would use common definitions for goods and services. Once a uniform definition is established, states would then indicate whether the good or service is taxable. In addition, states would also identify which entities would be exempt from paying sales taxes, e.g., non-profit or religious organizations.

Tax Base. The sales tax, which is often considered a consumption tax, is perhaps better identified as a transaction tax on tangible personal property; expenditures on Internet access, legal, and medical services are often excluded from the state sales tax base.[14] In many states, groceries are also exempt from the sales tax or taxed at a lower rate (see **Table 1**). A true consumption tax would include all income that is not saved, including personal expenditures on services.[15]

Business-to-business transactions are often exempt from the retail sales tax, particularly in cases where the purchaser is using the good as an input to production. These transactions are exempt because including the transactions could lead to the "pyramiding" of the sales tax. For example, if a coffee shop were to pay a retail sales tax on the purchase of coffee, and then impose a retail sales tax on coffee brewed for the final consumer, the total sales tax paid for the cup of coffee would likely exceed the statutory rate. Products that a business purchases for resale are typically not assessed a retail sales tax for a similar reason. If a coffee shop buys beans only for resale, levying a sales tax on the wholesale purchase of the beans and then on the retail sale would more than double the statutory rate. Tax treatment of business purchases is not uniform across states. According to recent estimates, approximately 18% of business purchases are taxable, more or less, depending on the state.[16]

Many individuals and organizations are also exempt from state sales taxes. Entities wishing to claim the sales tax exemption are often issued a certificate indicating their tax-free status and are required to present this certification at the point of transaction. Non-profit organizations, such as those whose mission is religious, charitable, educational, or promoting public health, often hold sales tax-exempt status.

Tax Rate. The second component of a sales tax is the tax rate applied to the base described in the previous section. In 39 states, local governments piggy-back a local sales tax (which often varies among localities within the state) on the state sales tax; 11 states and the District of Columbia levy a single rate (see **Table 2**) with no local taxes. Some states in the group of 39 may collect a uniform local tax along

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[14] For example, only two states tax medical services, Hawaii and New Mexico.

[15] A common identity in the economics of income accounting is the following: C=Y-S. Or, consumption (C) equals income (Y) less saving (S). Thus, income less savings is total consumption.

[16] Cline, Robert, John Mikesell, Tom Neubig, and Andrew Philips, "Sales Taxation of Business Inputs," *Council on State Taxation Special Report*, January 25, 2005.

with the state tax and send the local revenue share back to the localities. This structure would look like a single rate to the consumer because vendors typically do not differentiate between the state and local share. For example, vendors in Virginia levy a 5.0% sales tax on purchases and remit the entire amount to the state. The state then sends what would have been raised by a 1% tax back to the local jurisdiction where the tax was collected. The state of Virginia keeps the remaining 4.0%.

Generally, states with a broader base can collect the same amount of revenue at a lower rate than a state with a narrow base. Mississippi, Rhode Island, and Tennessee have the highest state sales tax rate of 7.0%. However, in 2005, Alabama had the highest potential combined state and local rate of 12.0%. Residents in high sales tax rate jurisdictions could gain from Internet purchases (and tax evasion) more than those in low tax rate states. Recognizing this potential revenue drain, many states have stepped up efforts to inform consumers of their responsibility to pay use taxes on internet and mail-order catalog purchases.[17] As suggested earlier, states with high rates — and whose residents have a greater incentive to evade taxes — are exposed to greater potential revenue losses from the growth of Internet commerce. Because of the greater potential losses, these states are more likely to support reforms that help maintain their sales and use tax revenue base.

Table 2 presents the sales tax rates for the 50 states, their localities, and the District of Columbia. Also reported in **Table 2** is the reliance (as measured by CRS) of state and local governments on the general sales (or gross receipts) tax. Even though gross receipts taxes have more in common with traditional business taxes, the Bureau of the Census combines them with general sales taxes.[18] Depending on the state law and the vendor, revenue generated by Internet transactions with out-of-state purchasers may or may not fall under the gross receipts tax.[19]

Internet Taxes: Economic Issues

During the debate about "Internet taxes," some economic issues will be important to consider. How will the treatment of Internet taxes influence the efficiency and equity of state tax systems? What will be the impact of changes in the treatment of Internet transactions on states that are more reliant on the sales tax? What will the potential revenue loss be absent changes in the treatment of Internet transactions? A summary of those issues follows below.

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[17] For example, see Chris Micheli, "California Strengthens Sales/Use Tax Collections," *State Tax Notes*, Dec. 15, 2003, pp. 964-965.

[18] The Bureau of the Census also collects data on excise taxes and selective sales. We do not report these receipts because they are typically collected at the wholesale level, not at the point of retail transaction. For example, the gasoline excise tax is typically paid by the carrier (tanker truck) at the point of collection (the end of the pipeline), not retail sale.

[19] Under a gross receipts tax (GRT), a vendor remits a designated percentage (e.g., 5% in New Mexico) of monthly gross receipts (or sales revenue) to the state. A gross receipts tax is different from the sales tax because the vendor is legally responsible for paying the tax, not the purchaser. Under the sales tax, the vendor acts as the collection agent for the taxing jurisdiction and is not technically "paying" the tax; the buyer is paying the tax.

Efficiency. A commonly held view among economists is that a "good" tax (or more precisely, an efficient tax) is one that does not significantly distort consumer behavior. Broadly speaking, individuals should make the same choices before and after a tax is imposed. The greater the distortions in behavior caused by a tax, the greater the economic welfare loss. A sales tax levied on all consumer expenditures equally would satisfy this definition of efficiency. However, as noted earlier, under the current state sales tax system, all consumption expenditures are not treated equally. The growth of tax-free Internet transactions, both business to business and business to consumer, will likely amplify the efficiency losses from altered consumer behavior.

An alternative theory for sales taxation is referred to as "optimal commodity taxation." Under an optimal commodity tax, the tax rate should be based on (or determined by) the price elasticity of demand for the product (sometimes called the "Ramsey Rule"). Conversely, products that are price *inelastic*, meaning quantity demanded is insensitive to changes in price, should be levied a higher rate of tax. Products that are price *elastic*, should have a lower rate of tax. If products purchased over the Internet are relatively more price elastic, then the lower tax rate created by effectively tax-free Internet transactions may improve economic efficiency. However, the price elasticity of products available over the Internet is difficult to measure and the efficiency gain, if any, would be small.[20]

An additional economic inefficiency would arise if vendors change location to avoid collecting sales taxes. The location change would likely result in higher transportation costs. In the long run, it is conceivable that the higher transportation costs would erode the advantage of evading the sales tax.

For example, consider a Virginia consumer who wants to buy a set of woodworking chisels.[21] The local Virginia hardware store sells the set for $50 (including profit). An Internet savvy hardware store in Georgia is willing to sell the same chisel set for $52 inclusive of profit and shipping costs. So, before taxes, the local retailer could offer the chisels at a lower price. The marginal customer, who is indifferent between the two retailers before taxes, is just as likely to buy from the Internet retailer as from the local retailer.[22]

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[20] Equity has both horizontal and vertical components. A tax is defined as horizontally equitable if people of equal circumstances pay equal taxes. A tax is defined as vertically equitable if people with a greater ability to pay carry a greater tax burden than those less able to pay. An optimal commodity tax would likely violate accepted principles of vertical equity.

[21] This example is based on one provided in Dennis Zimmerman, "The Internet Sales Tax Debate: Sorting Through the Economic Issues," paper prepared for the 94th Annual Conference, National Tax Association, Baltimore, MD, Nov. 8-10, 2001.

[22] The pre-tax absolute price difference between the two retailers is unimportant. The Internet price inclusive of shipping could actually be lower before taxes. The application of the use tax makes the local retailer's product *relatively* more expensive, regardless of what the prices were before taxes.

However, the Virginia state and local sales tax of 5.0% yields a final sales price to the consumer of $52.50. Given the higher relative price inclusive of the tax, the marginal consumer, along with many other consumers, would likely switch to buying chisels from the Georgia based Internet retailer (assuming these consumers do not feel compelled to pay the required Virginia use tax on the Internet purchase). The diversion from retail to the Internet in response to the non-collection of the use tax represents a loss in economic efficiency. The additional $2 in production costs ($52 less $50) represents the efficiency loss to society from evading the use tax.[23]

Note that if in the absence of sales and use taxes, the Internet vendor in the above example may yield to market forces and close up shop. However, if the Internet vendor continues to operate even without the tax advantage, it could be the case that consumers are willing to pay higher prices for the convenience of Internet shopping. If this were true, then the higher "production costs" for Internet vendors would not necessarily result in an efficiency loss.

Equity. The sales tax has often been criticized as a regressive tax, or a tax that disproportionately burdens the poor.[24] Assuming Internet shoppers are relatively better off and do not remit use taxes as prescribed by state law, they can avoid paying tax on a larger portion of their consumption expenditures than those without Internet access at home or work.[25] Consumers without ready Internet access are not afforded the same opportunity to "evade" the sales and use tax. In this way, electronic commerce may actually exacerbate the regressiveness of the sales tax, at least in the short run. As computers and access to the Internet become more readily available, the potential inequity arising from this aspect of the "digital divide" could diminish.

Differential Effect Among States. The growth of Internet based commerce will have the greatest effect on the states most reliant on the sales and use tax. In addition to having more revenue at risk, high reliance states also face greater efficiency losses because of their generally higher state tax rates. As noted earlier, higher rates drive a larger wedge between the retail price inclusive of the sales tax and the Internet price and thus exacerbate the efficiency loss from the sales tax. States with low rates (and less reliance) would tend to have a smaller wedge between the two modes of transaction. High rate-high reliance states would tend to recognize the greatest revenue loss from a ban on the taxation of Internet transactions.

Based upon CRS calculations of state and local sales tax revenue as a portion of total tax revenue, Washington, Tennessee, and Arizona, are the state and local

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[23] Shipping costs can be thought of as a cost of production. The local retailer probably also paid shipping costs to have the product on the shelf. Those costs are included in the price of the good. Because the local retailer likely bought in bulk, the shipping cost per unit would be considerably lower than the Internet retailer.

[24] A regressive tax collects a smaller percentage of income as income increases. Economists will usually avoid normative question of what is equitable because such a statement implies an interpersonal comparison of utility.

[25] Goolsbee and Zittrain (1999) found that the average Internet user had on average two more years of education and $22,000 more in family income than non-Internet users.

jurisdictions most reliant upon the sales and use tax.[26] In those states, over 40% of total tax revenue is derived from the sales tax. This result is not surprising: Washington and Tennessee do not have comprehensive personal income taxes and Arizona has a relatively high 11.6% combined sales tax rate. Ordinal rankings of sales tax reliance appear in the last column of **Table 2**. Note that the seven states without an income tax are all in the top 15 on the reliance index.[27] The District of Columbia would have been near the bottom of the reliance measure if it were a state. The third column (c) of **Table 2** reports the highest local sales tax rate for those states that levy local sales taxes.

Revenue Loss Estimates. Economists Donald Bruce and William Fox estimated in July 2004 that the "new e-commerce" loss in 2003 was approximately $8 billion.[28] "New e-commerce," as measured by Bruce and Fox, is the lost revenue from states not collecting the use tax on remote Internet transactions. This estimate excludes purchases made over the telephone or through catalogs that would have occurred anyway. An earlier General Accounting Office (GAO) report estimated that the revenue loss in 2003 from internet sales would be between $1.0 billion and $12.4 billion.[29] The wide range of the GAO estimate reflects the degree of uncertainty on the size of the potential state and local revenue loss from e-commerce.

The rapid growth of electronic commerce is exhibited by data provided by the U.S. Bureau of Census and could imply that the state and local revenue loss will grow over time. According to retail survey data from the U.S. Department of Commerce, "the third quarter 2004 e-commerce [sales] estimate [$17.6 billion] increased 21.5% from the third quarter of 2003."[30]

Policy Options

Congress can play a passive or active role in the remote vendor tax collection debate. A passive approach would end the moratorium, which expires on November 1, 2007, and not introduce any additional legislation that directly affects taxes on Internet commerce. A more active role would likely involve new limits on the ability of state and local governments to levy taxes on Internet access and to further regulate

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[26] In addition, those three states were well above the average state tax rate in the U.S. of just over 5.3% (of the 45 states with a state sales tax and the District of Columbia). The state tax rates for those three states were: Washington, 6.5%; Florida, 6%; and Tennessee, 7%.

[27] New Hampshire and Alaska are not included in the seven because neither has a state level sales tax on which to rely

[28] Donald Bruce and William F. Fox, "State and Local Sales Tax Revenue Losses from E-Commerce: Estimates as of July 2004," *University of Tennessee Center for Business and Economic Research*, July 2004, p.5.

[29] U.S. General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, GAO Report OCE-00-165 (Washington: June 30, 2000), p. 21.

[30] U.S. Census Bureau, Monthly Retail Surveys Branch, November 19, 2004, available at [http://www.census.gov/mrts/www/data/pdf/3q2004.pdf].

transactions conducted over the Internet. This section explores some possible outcomes and consequences of the two alternatives.

Passive Approach. This approach, not renewing the moratorium and inaction on the use tax collection issue, would implicitly maintain the current limitations on the states' ability to require remote vendors to collect sales and use taxes. Some observers believe that this course may result in states depending less on the sales tax because untaxed Internet transactions would, over time, significantly erode the revenue base. The lost sales tax revenue would likely be replaced by a tax source that is less stable, e.g. the individual income tax or corporate income tax. Unstable revenue sources are unwelcome to state officials who must balance their operating budgets annually (or biannually). And, unlike the federal government, states face constitutional (or legislated) restrictions on the use of debt and on the total amount of debt outstanding.[31] Thus, funding temporary shortfalls with borrowing is more difficult for state and local governments than for the federal government. A move away from the sales tax as a primary revenue source could present difficult fiscal choices for state and local governments.

Nevertheless, advocates of the passive approach suggest that a lower tax burden on Internet transactions would help small Internet retailers compete with larger, established retail entities. While a relatively lower tax burden would clearly help Internet vendors in the short run, direct payments to Internet vendors would seem to be a more transparent means of delivering a subsidy.

Opponents of congressional passivity on the sales and use tax collection issue focus on potential state revenue losses if Congress does nothing. Also, the differential tax treatment of Internet vendors and traditional bricks and mortar vendors is cited by opponents of congressional inactivity in the Internet tax debate. Finally, some critics of the passive approach believe that anticipated congressional action provides the impetus for state and local governments to simplify their sales tax systems.

Active Approach. The active options available to Congress range from (1) forbidding sub-federal governments from levying taxes on both Internet access and on transactions conducted over the Internet, regardless of nexus issues to, (2) requiring remote vendors (those without nexus) to collect and remit use taxes. The first option is unlikely without an accompanying concession by the federal government to compensate for the federal mandate. The second option is unlikely without action by the states and local governments to simplify and harmonize their tax regimes.[32]

Both extremes in the active approach have their supporters. However, proponents closely aligned with the first option, essentially creating an Internet tax-free zone, seem driven more by reducing taxes generally than by other policy concerns. Supporters closer to the other option are concerned about state revenue

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[31] All states except Vermont have some type of balanced budget rule.

[32] Charles McLure Jr., "SSTP: Out of Great Swamp, But Whither? A Plea to Rationalize the State Sales Tax," *State Tax Notes*, December 31, 2001, p. 1077.

losses as well as the apparent need to reform state and local taxes. These activists believe the Internet tax debate provides a unique opportunity to simplify and reform state and local sales taxes.

Table 1. State and Local General Sales and Gross Receipts Taxes as Percent of Total Personal Income, by State, FY2002

State (*italics* =no personal income tax)	GSGR State & Local Tax Revenue in FY2002 ($000's)	Food in State Base (2004)	State Personal Income 2002 ($ millions)	GSGR Tax as Percent of Personal Income 2002
(a)	(b)	(c)	(d)	(e)
Alabama	2,968,306	Y	112,737	2.63%
Alaska	121,944	n/a	20,699	0.59%
Arizona	5,783,197	N	142,868	4.05%
Arkansas	2,540,788	Y	63,720	3.99%
California	31,292,794	N	1,158,679	2.70%
Colorado	4,127,711	N	149,958	2.75%
Connecticut	3,043,971	N	147,784	2.06%
Delaware	0	n/a	26,465	0.00%
Dist. of Columbia	558,480	N	24,046	2.32%
Florida	15,034,278	N	494,648	3.04%
Georgia	7,493,304	N	246,720	3.04%
Hawaii	1,612,333	Y	37,348	4.32%
Idaho	796,373	Y	33,605	2.37%
Illinois	7,528,462	Y	420,913	1.79%
Indiana	3,798,490	N	173,932	2.18%
Iowa	2,016,193	N	83,051	2.43%
Kansas	2,294,733	Y	79,144	2.90%
Kentucky	2,312,322	N	104,691	2.21%
Louisiana	4,838,025	Y	114,064	4.24%
Maine	836,134	N	35,913	2.33%
Maryland	2,690,434	N	198,119	1.36%
Massachusetts	3,695,874	N	252,252	1.47%
Michigan	7,784,308	N	304,490	2.56%
Minnesota	3,782,249	N	171,026	2.21%
Mississippi	2,341,447	Y	64,248	3.64%
Missouri	4,246,139	Y	164,143	2.59%
Montana	0	n/a	22,755	0.00%

State (*italics* =no personal income tax)	GSGR State & Local Tax Revenue in FY2002 ($000's)	Food in State Base (2004)	State Personal Income 2002 ($ millions)	GSGR Tax as Percent of Personal Income 2002
(a)	(b)	(c)	(d)	(e)
Nebraska	1,287,487	N	51,480	2.50%
Nevada	2,216,779	N	65,596	3.38%
New Hampshire [f]	0	n/a	43,778	0.00%
New Jersey	5,996,839	N	338,912	1.77%
New Mexico	1,764,879	Y	44,412	3.97%
New York	16,630,208	N	690,488	2.41%
North Carolina	4,909,217	N	230,556	2.13%
North Dakota	394,508	N	17,109	2.31%
Ohio	7,686,517	N	335,841	2.29%
Oklahoma	2,600,204	Y	89,350	2.91%
Oregon	0	n/a	101,176	0.00%
Pennsylvania	7,500,034	N	391,354	1.92%
Rhode Island	731,597	N	33,503	2.18%
South Carolina	2,435,404	Y	104,320	2.33%
South Dakota	671,952	Y	20,468	3.28%
Tennessee [f]	5,841,589	Y	160,414	3.64%
Texas	18,321,523	N	621,832	2.95%
Utah	1,970,374	Y	56,299	3.50%
Vermont	214,746	N	18,231	1.18%
Virginia	3,586,938	Y	240,115	1.49%
Washington	9,231,321	N	198,317	4.65%
West Virginia	962,756	Y	42,682	2.26%
Wisconsin	3,913,811	N	162,818	2.40%
Wyoming	579,715	Y	15,249	3.80%

Sources: Columns (b) and (d), U.S. Bureau of Census; column (c) and table notes below, Federation of Tax Administrators; column (e), author's calculations.

Notes: Hawaii, Idaho, South Dakota, and Wyoming all offer an income tax credit to offset sales taxes on food. Snack food is not exempt in DC and ME. Food is subject to a reduced rate in IL, MO, SC, and VA. Food is subject to local sales taxes in Louisiana. Only capital income included in the personal income tax in NH and TN.

Table 2. State and Local Reliance on the Sales and Gross Receipts Tax, by State, FY2002

State	State Rate in 2005	Top Local Rate in 2005	Total State & Local Tax Revenue in FY2002 ($000's)	GSGR State & Local Tax Revenue in FY2002 ($000's)	GSGR Tax as % of FY2002 Tax Revenue	State Reliance Rank
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Alabama	4.000	8.000	9,718,827	2,968,306	30.5%	16
Alaska	n/a	7.000	2,069,908	121,944	5.9%	47
Arizona	5.600	5.000	14,420,322	5,783,197	40.1%	3
Arkansas	6.000	5.500	6,460,855	2,540,788	39.3%	5
California	6.250	2.500	120,424,066	31,292,794	26.0%	21
Colorado	2.900	7.000	13,900,024	4,127,711	29.7%	17
Connecticut *	6.000	n/a	15,124,928	3,043,971	20.1%	36
Delaware	n/a	n/a	2,687,098	0	0.0%	50
Dist. of Columbia	5.750	n/a	3,227,909	558,480	17.3%	42
Florida	6.000	1.500	44,840,449	15,034,278	33.5%	11
Georgia	4.000	4.000	24,058,380	7,493,304	31.1%	14
Hawaii *	4.000	n/a	4,239,557	1,612,333	38.0%	6
Idaho	6.000	3.000	3,291,095	796,373	24.2%	26
Illinois	6.250	3.000	41,569,580	7,528,462	18.1%	40
Indiana *	6.000	n/a	16,986,637	3,798,490	22.4%	28
Iowa	5.000	2.000	8,330,414	2,016,193	24.2%	25
Kansas	5.300	3.000	7,974,975	2,294,733	28.8%	19
Kentucky *	6.000	n/a	10,780,757	2,312,322	21.4%	30
Louisiana	4.000	6.750	12,182,065	4,838,025	39.7%	4
Maine *	5.000	n/a	4,541,146	836,134	18.4%	39
Maryland *	5.000	n/a	19,874,281	2,690,434	13.5%	45
Massachusetts *	5.000	n/a	23,895,436	3,695,874	15.5%	44
Michigan *	6.000	n/a	30,644,184	7,784,308	25.4%	22
Minnesota	6.500	1.000	18,456,409	3,782,249	20.5%	34
Mississippi	7.000	0.250	6,523,722	2,341,447	35.9%	9
Missouri	4.225	4.375	15,123,432	4,246,139	28.1%	20
Montana	n/a	n/a	2,135,182	0	0.0%	50
Nebraska	5.500	1.500	5,316,341	1,287,487	24.2%	24

State	State Rate in 2005	Top Local Rate in 2005	Total State & Local Tax Revenue in FY2002 ($000's)	GSGR State & Local Tax Revenue in FY2002 ($000's)	GSGR Tax as % of FY2002 Tax Revenue	State Reliance Rank
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Nevada	6.500	1.000	6,432,564	2,216,779	34.5%	10
New Hampshire	n/a	n/a	3,598,862	0	0.0%	50
New Jersey *	6.000	n/a	34,628,804	5,996,839	17.3%	41
New Mexico	5.000	2.750	4,877,614	1,764,879	36.2%	8
New York	4.250	4.500	88,878,112	16,630,208	18.7%	38
North Carolina	4.000	3.000	22,576,419	4,909,217	21.7%	29
North Dakota	5.000	2.500	1,728,755	394,508	22.8%	27
Ohio	6.000	2.000	36,165,190	7,686,517	21.3%	31
Oklahoma	4.500	6.000	8,781,889	2,600,204	29.6%	18
Oregon	n/a	n/a	9,003,237	0	0.0%	50
Pennsylvania	6.000	1.000	37,626,620	7,500,034	19.9%	37
Rhode Island *	7.000	n/a	3,622,244	731,597	20.2%	35
South Carolina	5.000	2.000	9,751,701	2,435,404	25.0%	23
South Dakota	4.000	2.000	1,841,448	671,952	36.5%	7
Tennessee	7.000	2.750	12,973,768	5,841,589	45.0%	2
Texas	6.250	2.000	58,980,508	18,321,523	31.1%	15
Utah	4.750	3.250	6,026,142	1,970,374	32.7%	12
Vermont	6.000	1.000	1,965,132	214,746	10.9%	46
Virginia	4.000	1.000	22,131,246	3,586,938	16.2%	43
Washington	6.500	2.400	19,513,503	9,231,321	47.3%	1
West Virginia *	6.000	n/a	4,641,349	962,756	20.7%	33
Wisconsin	5.000	1.000	18,609,916	3,913,811	21.0%	32
Wyoming	4.000	2.000	1,818,368	579,715	31.9%	13

Sources: Columns (b) and (c): Sales Tax Institute, [http://www.salestaxinstitute.com]. Columns (d) and (e): U.S. Bureau of Census. Column (f) and (g): author's calculations.

* Identifies the 11 states that do not have a local sales tax