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State Administration of a National Sales Tax: A New Opportunity for Cooperative Federalism

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STATE ADMINISTRATION OF A NATIONAL SALES TAX: A NEW OPPORTUNITY FOR COOPERATIVE FEDERALISM

*John A. Miller**

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I. INTRODUCTION

The desirability of congressional enactment of a national sales tax has long been a topic of debate.¹ It was once suggested that

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¹ See S. Surrey, *A Value-Added Tax for the United States—A Negative View*, in *Tax*

such a tax might be included in the 1989 tax agenda.² It is reasonably certain that such suggestions will continue to arise. There are a number of important policy issues bearing on the question of whether such a tax should be enacted. For the moment, the most prominent argument in support of enactment is that a national sales tax is necessary in order to eliminate our persistent federal budget deficits;³ but there are, of course, many points of debate regarding the wisdom of such an enactment.⁴ These issues include the alleged regressivity of sales taxes, their potential for fueling inflation, their role in encouraging savings and capital formation, and the possible detrimental effects on state-revenue raising capabilities of a national sales tax. Even assuming enactment of a federal sales tax is desirable, there is a significant debate over its appropriate form. The two main contenders in this conflict are the retail sales tax and the value-added tax.⁵ A practical concern is the manner in which such a tax would be administered.

This article hypothesizes that the state revenue agencies, nearly all of which already collect and enforce a retail sales tax, present a logical, economically expedient alternative to the establishment of yet another federal bureaucracy for purposes of administering a national sales tax. The most important caveat to this proposition is that adoption of a federal value-added tax would render combined

Policy and Tax Reform: 1961—1969, Selected Speeches and Testimony of Stanley S. Surrey 475 (W. Hellmuth & O. Oldsman ed. 1973); Schenk, Value Added Tax: Does This Consumption Tax Have a Place in the Federal Tax System?, 7 Va. Tax Rev. 207, 225 (1987).

² See Skadden, 1989 Tax Agenda May Include a Value-Added Tax, 38 Tax Notes 547 (Feb. 8, 1988). See also Rosenthal, The 1989 Tax Debate: Consumption Taxes and Sacred Cows, 39 Tax Notes 1501 (June 27, 1988).

³ See, e.g., Aaron, The Political Economy of a Value-Added Tax in the United States, 38 Tax Notes 1111 (March 7, 1988); Brannon, The Value Added Tax is a Good Utility In-Fielder, 37 Nat'l Tax J. 303 (1984); Koch Makes a Case for a National Value-Added Tax as a Revenue Enhancing Measure, 37 Tax Notes 1205, 1206 (Dec. 21, 1987); Sheppard, Why We Need a Vat, 34 Tax Notes 529 (Feb. 9, 1987). This argument was being considered even prior to the Reagan Era deficits. See Calkins, The Role of The Value-Added Tax in the Developing United States Tax System, 6 J. Corp. L. 83, 101 (1980).

⁴ See, e.g., Schuyler, Consumption Taxes: Promises and Problems, 25 Tax Notes 571, 575 (Oct. 5, 1984); Should the United States Adopt the Value-Added Tax?—A Survey of Policy Considerations and the Data Base, 26 Tax Law. 45 (1972) (questioning the wisdom of such an enactment).

⁵ But cf. Zodrow, A Direct Consumption Tax as an "Add-On" Tax, 38 Tax Notes 1389 (March 21, 1988). See also Carlson & Gordon, VAT or Business Transfer Tax: A Tax on Consumers or on Business?, 41 Tax Notes 329 (Oct. 17, 1988); A. Robinson, The Retail Sales Tax in Canada, Can. Tax Paper No. 77, 26 (Can. Tax Found. 1986).

administration less practical unless the states were willing to convert from the retail sales tax model to the value-added tax model.

II. THE BASIC THEORY

The basic theory is this: the states' sales tax collection bureaucracies will collect the federal sales tax and remit it to the federal treasury. In return, the states will receive a percentage of their collections as reimbursement for their expenses and as an incentive for assuming the collection role. The policy formulations necessary to flesh out the statutory framework of the federal tax will be devised at the federal level in order to assure the uniformity of taxation which both fairness and the Constitution require. For the same reason, litigation concerning the federal tax also will be handled by federal employees in federal courts. Thus, the state sales tax bureaucracies will assume a ministerial role with respect to the federal tax, while the discretionary functions with respect to the tax will reside with federal officials.

It has been estimated that the Internal Revenue Service ("Service") would require 50,000 additional employees to implement a national value-added tax ("VAT").⁶ Other estimates are lower but still indicate a major administrative investment.⁷ It is probable that a national retail sales tax ("RST"), which differs from a consumption VAT in form but not in substance,⁸ would require nearly as many employees as a VAT for implementation.⁹ Even those who

⁶ Due, *Economics of the Value-Added Tax*, 6 J. Corp. L. 61, 75 (1980).

⁷ The Treasury estimated that a fully implemented VAT would require 20,694 staffing positions and would cost \$696.2 million per year to administer. 3 U.S. Dep't of the Treasury, *Tax Reform for Fairness, Simplicity and Economic Growth: The Treasury Department Report to the President 1*, 128 (1984) [hereinafter *Treasury Report*].

⁸ *Id.* at 62. See also McDaniel, *A Value Added Tax for the United States? Some Preliminary Reflections*, 6 J. Corp. L. 15, 16 (1980); Schenk, *supra* note 1, at 226, 240-41.

⁹ Some might take issue with this contention because a VAT involves more tax collecting points than a RST in theory. In a VAT, manufacturers and wholesalers are part of the remittance chain and, thus, must be audited. In a RST, only retailers are the collectors, so taxpayers who must be audited are fewer in number.

Two factors run counter to the assumption that a VAT requires greater bureaucracy for administration than a RST. First, it is argued that a VAT tends to be more self-policing than a RST because each taxpayer, except the consumer, is entitled to deduct the VAT he paid his seller from the VAT he collected from his customers. Thus, each taxpayer's records tend to establish the accuracy or inaccuracy of the business records of those who deal with him. This provides an incentive toward keeping accurate records and paying the proper amount of tax. On the other hand, a RST is more vulnerable to underpayment and report-

favor enactment of a national sales tax have no enthusiasm for the creation of another federal bureaucracy;¹⁰ and to those who oppose a national sales tax, the administrative cost and complexity of such a tax offer yet more reasons for their opposition.¹¹ Compliance costs for businesses raise similar issues.¹²

Any method of administering a tax will have its costs. However, it is at least logical, if not obvious, that the maintenance of two bureaucracies to collect two substantially identical taxes on the same class of transactions will be significantly more expensive than the maintenance of one bureaucracy to administer both taxes. For example, sales tax audits constitute a major cost of administering such a tax.¹³ If the two taxes are administered separately, two audits must be done of any taxpayer whose compliance with both taxes is sought to be determined. By administering the two taxes in a single agency, one audit could determine compliance with both taxes. This results because both taxes relate to the same transactions; rely on the same documents which consist primarily of invoices and receipts; and are audited using the same basic techniques such as random samplings, test periods, and average markups. Of course the auditor must be familiar with and account

ing of tax, especially in cash transactions. This view, however, has been challenged by proponents of the RST.

A second, less debatable, factor which implies that a RST will require as many administrators as a VAT is that most wholesalers and manufacturers are part of the audit and tax collection system even in a RST regime. Their records must be examined periodically to properly calculate a retailer's liability. And many, if not all, of the wholesalers and the manufacturers will have some direct sales or use tax liability of their own. For instance, a gasoline refiner will purchase unrefined oil tax free because it is a manufacturer. It may consume some of the oil in its operations, thus incurring a use tax liability. It may also sell fuel directly to ultimate consumers, such as airlines or fishing fleets and, thus, also subject itself to tax liability as a retailer.

The Treasury has estimated that a RST would require 10% fewer staffing positions than a VAT. Treasury Report, *supra* note 7, at 32.

¹⁰ See, e.g., Sheppard, *Why We Need a VAT*, 34 Tax Notes 529 (Feb. 9, 1987).

¹¹ See S. Surrey, *supra* note 1, at 484-85; Due, *supra* note 6, at 74-75, 80; Schenk, *supra* note 1, at 300. See also Rosenthal, *supra* note 2, at 1501.

¹² In a somewhat different context it has been observed that "[o]ne of the central objectives of any tax system is that it be efficient. Resources unnecessarily spent on compliance and administration constitute nothing other than a waste of society's precious resources which could be beneficially applied elsewhere." Turnier, *Designing an Efficient Value Added Tax*, 39 Tax L. Rev. 435, 471 (1984).

¹³ The Treasury estimated that roughly one third of the staffing positions needed to administer a national VAT would relate to returns processing. See Treasury Report, *supra* note 7, at 128.

for differences between the two taxes, but this is a minor consideration assuming a competent auditor.¹⁴ Nevertheless, it must be recognized that the greater the similarity between the two taxes, the greater will be the economy in administering them together.

The idea of piggybacking the administration of one jurisdiction's tax on another jurisdiction's tax is not new, even in the context of a national sales tax. Generally, commentators have focused on the idea of piggybacking a state sales tax on a national sales tax,¹⁵ but it is the states which possess the personnel and the expertise for the administration of sales taxes.¹⁶ Many states enacted sales taxes as early as the 1930's,¹⁷ and as a consequence, have developed highly systematic, well reasoned schemes of enforcement and administration. The RST is the most important revenue source for the states.¹⁸ Why should the states dismantle their established bureaucracies and trust the untested efforts of an addition to an already bloated federal bureaucracy? More to the point, why should the federal government start from scratch to establish a massive new bureaucracy when the means to the desired end is already in place?

III. THE QUESTION OF PRACTICALITY

The simplest way to establish the practicality of combined administration of state and national sales taxes by the states is to recognize that it has already been done under circumstances considerably more difficult than those existing in the United States. Reference here is made to the European Community's and its member states' implementation of a combined state and federal

¹⁴ It should be remembered that when we assume the existence of two sales taxes we are requiring the retailer to be familiar with and to account for the differences between the two taxes. If we can expect this of the retailer, surely we can expect it of a professionally trained auditor.

¹⁵ See, e.g., McClure, *State and Federal Relations in the Taxation of Value Added*, 6 J. Corp. L. 127, 136-37 (1980) (tentatively concluding that revenue sharing made more sense).

¹⁶ Currently, forty-five states administer a general sales tax. See J. Due & J. Mikesell, *Sales Taxation, State and Local Structure and Administration* 4 (1982). See also Council of State Governments, *The Book of the States* 251, 254 (27th ed. 1988).

¹⁷ See B. Terra, *Sales Taxation: The Case of the Value Added Tax in the European Community* 4 (1988) (citing J. Due and J. Mikesell, *supra* note 16, at 2).

¹⁸ See Manvel, *The Tax Reform Act and General Sales Taxes*, 39 Tax Notes 525, 527 (April 25, 1988). This has been true at least since the early sixties. See D. Morgan, *Retail Sales Tax* 3 (1964).

VAT administered at the member state level.¹⁹ When one considers the barriers of nationality, language, governmental structure, and currency which were overcome in establishing a combined VAT administration in Europe, the problems faced in the United States in implementing such a combined administration pale by comparison. The United States has a long history of intergovernmental cooperation; and it benefits from a single national language, a single currency, and similarly structured state governments.²⁰

Nonetheless, a few years ago John F. Due, a noted commentator in the sales tax field, wrote:

[P]iggybacking a federal sales tax on the state sales taxes is virtually impossible given the diversity in state sales taxes and the loss of autonomy that would result if the federal government sought to force them to uniformity.²¹

The import of Due's statement turns in major part on the meaning ascribed to the word "piggybacking." If piggybacking means "revenue sharing"²² in which the federal tax forms an exact overlay of the various state sales taxes, then Due's opinion is beyond dispute.²³ Because sales tax laws vary to some extent from state to state, the uniform administration of the federal tax throughout the United States would by definition be an impossibility if the federal tax were piggybacked on the state taxes. If piggybacking, however, simply means that both the state and the federal tax would be ad-

¹⁹ This is derived from the Council decision of April 21, 1970, to replace financial contributions from member states with the Communities' own resources. For a copy of this decision, see P. Guieu, *The Sixth Council Directive on the Value Added Tax, Uniform Basis of Assessment 108 (1977)*. Implementation of this decision was by Council Regulation. See *id.* at 127-33.

²⁰ The revenue agencies of the various states are organized in a number of different fashions, but most utilize a single commissioner who is often appointed by the governor. J. Due & J. Mikesell, *supra* note 16, at 106. The Revenue agencies' personnel have long associated themselves in regional and national bodies, some of which serve important policymaking roles, such as the National Association of Tax Administrators and the Multistate Tax Commission.

²¹ Due, *supra* note 6, at 76.

²² Piggybacking may be seen as nothing more than a form of revenue sharing. See *Technical Problems in Designing a Broad-Based Value-Added Tax for the United States*, 28 *Tax Law* 193, 219 (1973). Some form of revenue sharing is a frequently mentioned vehicle for allaying state concerns over the invasion of the sales taxation arena by the federal government. See, e.g., Aaron, *supra* note 3, at 1115.

²³ Presumably, this is what Due meant.

ministered by a single agency within the boundaries of any given state, then a different conclusion may result. Under the assumption that piggybacking has taken on the meaning apparently ascribed to it by Due in the field of taxation, the preferred terminology for purposes of this article is the phrase "combined administration" as opposed to "piggybacking."

Regardless of whether Due's view of combined administration would be any different from that expressed in the above quoted statement about piggybacking,²⁴ it must be recognized that he has raised a significant issue concerning the practicality of combined administration. Is the diversity of state sales taxes a serious obstacle to combined administration? The answer to that question depends upon the extent of that diversity.

Sales taxes differ from state to state not in their general application but in the variety of exemptions enacted by the state legislatures. All of the existing state sales taxes are RST's,²⁵ but they differ in the extent to which they apply to service transactions.²⁶ Otherwise, however, their general scope is the same in that they are taxes levied as a percentage of the sales price on retail transactions involving the transfer of tangible personal property. As a practical matter, the tax is always collected by the retailer regardless of whether the legal incidence of the tax is on the retailer or the consumer.²⁷ While the rate of tax varies from state to state, this variance is of no particular significance for combined adminis-

²⁴ The feasibility of coordinating administration of a federal VAT and the states' RSTs was characterized as "doubtful" by economist George Carlson "[b]ecause of likely differences in the tax bases." Carlson, *Economic and Political Aspects of a U.S. Value-Added Tax*, 10 *Tax Notes* 699, 702 (May 12, 1980).

²⁵ See J. Due & J. Mikesell, *supra* note 16, at 5-6.

²⁶ See *id.* at 6; Pierce & Peacock, *Broadening the Sales Tax Base: Answering One Question Leads to Others*, 14 *Fla. St. U.L. Rev.* 463, 465 (1986).

²⁷ See J. Due & J. Mikesell, *supra* note 16, 24-25. The person who actually bears the economic burden of the sales tax is a matter of debate. The general theory is that the consumer bears the burden, but some argue persuasively that this view is too simplistic and that the ultimate burden falls, in part at least, on the seller. See D. Morgan, *supra* note 18, at 4-5, ch. VI; B. Terra, *supra* note 17, at 12. See also N. Jacoby, *Retail Sales Taxation* 1, 299-304 (1938); C. Sullivan, *The Tax On Value Added*, ch. 7 (1965); Ture, *The Basic Economics of a U.S. VAT*, 6 *J. Corp. L.* 49, 56 (1980); Waldauer, *Economic Effects of the Tax Restructuring Act of 1979*, 6 *J. Corp. L.* 103, 106, 110 (1980).

For an amusing bit of dialogue on this issue, see Letter from Cliff Massa, III, 38 *Tax Notes* 1415 (March 21, 1988) (suggesting a tax symposium should examine the shared incidence theory), and Response by Norman Ture, 38 *Tax Notes* 1516 (March 28, 1988) (taking Massa to task for failing to know that the theory is widely known and accepted).

tration of the taxes. Thus, the diversity of the states' sales taxes may be characterized as consisting primarily of variations on the same theme. To the extent that a federal tax is harmonized with that main theme, orchestration of the two taxes by a single administration in each state is feasible.

Of course, the existence of exemption and exclusion variance among the states' RST's is both undeniable and problematic. These differences do not establish, however, that combined administration is impractical; but they do suggest that a straightforward federal RST would be a major boon to combined administration. If the federal government resists the temptation to make its sales tax a complex maze of exemptions and differing rates, the complexity of any given state sales tax is only a hindrance, not a fatal flaw. Regardless of whether there are two tax administrations or one, it should be remembered that the retailer will have to collect and remit two taxes.²⁸ Thus, even if both taxes are relatively complex, combined administration by a single agency should be no more difficult than dual collection and remittance by the hapless retailer. Furthermore, combined administration of both national and state taxes should be more efficient for the retailer as well as the governments, because the retailer can expect half as many audit visits and can deal with the same people with respect to many of the state and federal sales tax matters.

A more difficult scenario for successful combined administration would be presented by federal enactment of a VAT. Although a

²⁸ Charles McLure has suggested that a dual system of uncoordinated retail sales taxes "would greatly complicate taxpayer compliance, as well as involving inefficient Federal duplication of administrative effort by state and local governments." McLure, *State and Local Implications of a Federal Value-Added Tax*, 38 *Tax Notes* 1517, 1528 (March 28, 1988). McLure further argues that a coordinated RST would be "far superior" and contends that federal collection of the state RST is a logical extension of that premise. *Id.*

In a footnote he adds that "state collection of a Federal surcharge makes no sense at all. Tax administration would not be uniform throughout the nation, tax bases would be different in each state, and the *National Bellas Hess* problem would not be solved." *Id.* at n.32. It is not clear what is meant by "Federal surcharge" in this context, but presumably he is talking about a true piggyback because he states that the tax bases would differ from state to state. If so, then he is correct, as was stated previously in the discussion of Due's comment on state/federal piggybacking. Apparently, McLure did not consider uncoordinated dual state/federal RST's administered by the states to be within the realm of possibilities, because in his textual comment quoted at the outset of this footnote, he seems to assume that federal administration of the federal tax is inevitable. McLure's allusion to the *National Bellas Hess* problem raises an issue which will be considered later.

VAT and a RST can be identical in substance, they are significantly different in form. The principal difference is that the typical VAT, i.e., the European VAT, employs a multistage collection format while the RST is a single stage tax by definition.²⁹ This means that manufacturers and wholesalers are included in the collection network of the VAT while, in theory at least, only retailers are RST remitters. The administrative importance of this distinction, however, may not be as great as one might expect, because even under an RST regime most manufacturers and wholesalers, in practice, are part of the audit and remittance pool.³⁰ Thus, the combined administration of a federal VAT and a state RST by the state revenue agency would not constitute as great an enlargement of its duties as a merely theoretical comparison of the two systems would suggest.³¹

The principal difficulty with combined administration of a federal VAT and a state RST would be the degree of sophistication such a system would require of the administrators. Auditors, their supervisors, and other compliance personnel would need to understand both systems thoroughly. As noted previously, however, with or without combined administration the entrepreneur-taxpayer will also be expected to understand and comply with both systems. Is it fair to expect anything less of the government administrators? In truth, neither a VAT nor a RST is formidably complex. Of the two, the VAT is the more conceptually difficult. Even so, its essential administrative features are straightforward and comprehensible.³² In particular, under a typical VAT the tax is simply collected by the seller as a percentage of the purchase price, similar to a

²⁹ For a discussion and analysis of the characteristics of the various sales taxes, see B. Terra, *supra* note 17, ch. IV.

³⁰ See *supra* note 9.

³¹ This also suggests that conversion by a state from a RST to a VAT would involve relatively little administrative overhaul.

³² Basically, the noncumulative, multistage, credit VAT works like this: At each stage of production, the selling entrepreneur collects the VAT as a set percentage of the sales price; the selling entrepreneur deducts the VAT he paid for his materials from the VAT he collects and remits the excess; similarly when his buyer sells the product or service, he (the buyer) deducts the VAT paid to his seller from the VAT he (the buyer) collects from his buyer before remitting the excess; and so this process continues until there is a non-entrepreneurial purchase which carries with it no entitlement to deduct the VAT collected from the purchaser. Therefore, the non-entrepreneur buyer bears the full weight of the tax to the same extent as under a RST regime. For a more detailed discussion of the available systems for levying the VAT, see B. Terra, *supra* note 17, ch. V.

RST. Thus, as in a RST regime, the primary audit records are receipts and invoices. No reason exists why a single invoice could not reflect the payment of both federal VAT and state RST where both apply to the transaction. Nonetheless, while combined administration of a federal VAT and a state RST may be technically feasible, it is acknowledged that such an approach would be far inferior in administrative efficiency to combined administration of either a federal RST and a state RST or a federal VAT and a state VAT.³³

Also, combined administration at the policymaking and litigation levels is not appropriate. In order to assure uniformity of interpretation and application of the federal tax, the Treasury would need to publish regulations, revenue rulings, letter rulings, etc., just as it does with the current federal taxes. Similarly, litigation arising under the federal tax law should be handled by federal attorneys in federal courts to assure reasonable uniformity of the law. Those costs are small, however, compared to the overall administrative costs of a sales tax.³⁴

Due was also doubtful that the states would accept the loss of autonomy which would result if the federal government sought to force the uniformity on the states' sales tax laws entailed by piggybacking. But if combined administration of state and federal sales taxes does not depend on uniformity between the two taxes, there is no reason for the federal government to seek to force uniformity. Admittedly, the states would have some incentive to minimize the differences between the two taxes so as to ease the burden of combined administration, but any state conformity to federal law would be entirely voluntary. Furthermore, as will be

³³ Cf. McLure, *supra* note 28, at 1528 (concluding that a combination of state RST's and a federal VAT creates an "unworkable" situation). As noted in the opening paragraph of the McLure article, it is a matter of some debate whether the RST is to be preferred over the VAT. For a sampling of opinions as to the relative merits of the two, see S. Surrey, *supra* note 1, at 485; B. Terra, *supra* note 17, ch. XIII; Cnossen, VAT and RST: A Comparison, 35 *Can. Tax J.* 559 (1987); Due, *The Choice Between a Value-Added Tax and a Retail Sales Tax*, 37 *Can. Tax Found. Conf. Rep.* 16:1 (1984); Gillis, *Excising Excises: Federal Sales Tax Reform in Canada*, 36 *Can. Tax Found. Tax Conf.* 473 (1984); McLure, *supra* note 28, at 1520.

³⁴ The Treasury's estimates concerning the costs of administration of a federal VAT should be considered. The major costs are those of examination, returns processing, and collection. Together, such costs comprise over \$500 million of the estimated \$700 million needed to administer the tax. These are all areas in which state administration could be substantial if not total. See Treasury Report, *supra* note 7, at 128, app. 9-B.

discussed later,³⁵ the incentive for voluntary conformity of the state tax to the configuration of the federal tax represents a positive change.

The diversity of state sales tax law does not bar combined administration of state and federal sales taxes by the state revenue agencies, because the diversity is peripheral. At the foundation the states utilize the same tax base and the same collecting point, and those are the most significant features necessary for efficient combined administration.

IV. ADVANTAGES OF COMBINED ADMINISTRATION

The chief advantage of combined administration is avoidance of the duplication of cost and effort by both the government and the taxpayer entailed by the operation of two separate bureaucracies to collect the state and the federal sales taxes. There are other possible advantages, however, including shorter start-up time, better coordination of the taxes, and systemic pressure for simplicity.

A shorter start-up time for implementation of the federal tax may be deduced from the fact that state combined administration would incorporate an existing enforcement scheme, while federal administration would involve establishing an appropriate bureaucratic structure.³⁶ Admittedly, the state agencies would be understaffed initially, and training in the nuances of the federal law would be required. At the very least, however, the administration would begin with a comprehensive structure staffed by personnel already familiar with sales tax law and sales tax administration. As new personnel are brought into the system, they would be trained by people who already possess a high level of understanding of the job to be done. In addition, as technical problems arise there would be existing consultative and cooperative networks to assist in reaching optimal solutions. For instance, there are regional and national associations of state tax administrators which facilitate communication and mutual assistance between the state revenue agen-

³⁵ See *infra* notes 39-41 and accompanying text.

³⁶ One commentator has suggested that it would take the Service eighteen months to two years to get geared up to collect a VAT. See Aaron, *supra* note 3, at 1115. The Treasury noted that the countries adopting VAT's have preceded implementation with one to two year public information campaigns. See Treasury Report, *supra* note 7, at 122. If a federal RST were adopted, public familiarity with state RST's would tend to obviate the need for extensive public education.

cies and their personnel.³⁷ The existence of a core group of longtime sales tax administrators directly involved in the implementation and collection of the federal tax could serve to ease what otherwise might be a highly traumatic transition period.

Combined administration also would ease the coordination problem which could arise as retailers grapple with integrating the federal tax into their existing collection and reporting systems.³⁸ Because the administrators would know both the state and the federal laws, they would better grasp the difficulties faced by taxpayers. Combined administrative responsibilities would also push the bureaucrats toward treating taxpayer compliance problems in a holistic manner.

As discussed previously, as the similarity between the federal tax and the state tax increases, the easier and more economical becomes compliance. With separate administrations, the governments have nothing beyond disinterested generosity as an incentive toward uniformity. On the other hand, under a combined administration regime there is a clear administrative advantage to uniformity. This not only promotes business compliance, but also creates structural pressure against elaborate exemption schemes because complexity and uniformity are antithetical in the absence of total piggybacking.³⁹ To illustrate, suppose the health food industry lobbies Congress for an exemption for vitamins from the national sales tax. States which do not have such an exemption in their sales tax laws have a structural incentive to oppose the exemption, because the exemption will be inconsistent with their existing laws and thus difficult to administer. In addition, Congress has a ready justification for declining to create the exemption by noting the increased burden it would place upon administrators

³⁷ Some of these include the Multistate Tax Commission, the National Association of Tax Administrators ("NATA"), and the various regional counterparts of NATA.

³⁸ As noted previously, McLure contends that uncoordinated dual RST's would pose an extremely serious burden on retailers. See *supra* note 28.

³⁹ One can argue against this proposition, of course. Many states maintain a significant degree of uniformity with federal laws in the income tax field despite the complexity of those laws. Nevertheless, one can also wonder if the federal income tax laws would be as complex if their administration was a state responsibility. Moreover, uniformity is achieved through what might be called quasi-piggybacking; that is, in theory the states administer their income taxes independently while adopting federal law as of a certain date. In reality, many states rely on the auditing of the Service and other enforcement functions for much of the taxpayer compliance with their own laws.

and businesses in a combined tax system. Similarly, if the health food industry lobbies a state legislature for such an exemption, the legislature has an incentive (and a justification) against succumbing if there is no identical federal exemption in the statutes. Possibly not too much should be made of this structural crossfire. Sales tax exemptions have proven quite prolific in most states;⁴⁰ but if maintaining a broad tax base and a uniform rate is preferable,⁴¹ this structural pressure against exemptions is one more reason to favor combined administration.

V. DIFFICULTIES WITH COMBINED ADMINISTRATION

The most prominent hazard of combined administration by the states is the potential for a lack of uniformity in administration of the federal tax.⁴² Such a lack of uniformity could come about through differing levels of commitment to administration among the states. In addition, an inherent tendency probably exists towards less uniformity in a less centralized system. Moreover, there is some evidence that the quality of tax administration varies from state to state;⁴³ but the available data suggests that the sales taxes in most states are efficiently administered.⁴⁴ The single most important improvement needed in most states is increased auditing.⁴⁵ This need is somewhat counterbalanced by improved processing in recent years brought about by more computerization.⁴⁶ Also, federal income tax audits have been steadily decreasing for years, and

⁴⁰ See J. Due & J. Mikesell, *supra* note 16, ch. 3.

⁴¹ Most commentators believe the avoidance of exemptions and differing rates to be highly preferable despite the implications this may have for regressivity. See B. Terra, *supra* note 17, at 41-43; Cnossen, *supra* note 33, at 607-09. The obvious advantage of permitting few or no exemptions is that revenue needs can be met with a lower rate of tax. The Tax Reform Act of 1986, which dropped the top individual income tax marginal rate from 50% to 28%, illustrates this point. The Act was designed to be revenue neutral.

⁴² Here we refer to a lack of administrative uniformity, not the lack of legal uniformity which would result if the federal tax were piggybacked on the various state sales taxes. See *supra* note 21 and accompanying text.

⁴³ The qualitative differences in tax administration are difficult to quantify. Due and Mikesell have made comparisons of delinquency records indicating a fairly high degree of uniformity among the states. See J. Due & J. Mikesell, *supra* note 16, at 201, Table 7.6. Those authors conclude that the differences between high and low delinquency states are the result of differing enforcement policies. *Id.* at 202.

⁴⁴ Due and Mikesell reach this conclusion. See *id.* at 330.

⁴⁵ *Id.*

⁴⁶ *Id.*

the likelihood of a federal income tax audit varies from region to region.⁴⁷ Thus, shortcomings in state administration of a federal sales tax could well be mirrored by similar shortcomings in federal administration.

Assuming that federal guidance to the states is adequate, uniform administration of the federal tax by the states is feasible. The quality of state compliance personnel and auditors is acceptable,⁴⁸ and the increased staffing necessary to administer the federal tax without any decline in state tax enforcement could be financed through commissions paid to the states by the federal government. Federal guidelines could be established for the number of audits required of the states, and other appropriate standards could be set to insure equal levels of enforcement activity throughout the states.

Another apparent difficulty is that five states do not currently levy a retail sales tax⁴⁹ and presumably, therefore, do not have a bureaucracy in place to assume an administrative role with respect to a federal sales tax. In those states, the federal government might administer the tax out of necessity. Arguably some of the benefits of combined administration by the other states are lost because the federal government is forced to develop a sales tax collection bureaucracy of its own, even if such bureaucracy only operates within five geographically limited spheres. The problem posed by the states which do not levy a sales tax, however, is not inconsistent with the basic proposition supporting combined administration. The fact remains that in the states which do levy a sales tax, combined administration promises to eliminate the need for a substantial new federal presence. In addition, although a state lacks a sales tax of its own, such a state still could administer the federal tax. Moreover, the states which do not currently levy a sales tax could adopt a sales tax and engage in a combined administration of the two taxes as in the other states. Whether either of these developments is likely to occur is a matter of conjecture, but the perceived benefits flowing to the states from combined administration, such

⁴⁷ See Guttman, *The IRS Audit: How Likely and How Much?*, 39 *Tax Notes* 557 (May 2, 1988).

⁴⁸ See J. Due & J. Mikesell, *supra* note 16, at 118-21.

⁴⁹ The states not currently levying a retail sales tax are Alaska, Delaware, Montana, New Hampshire and Oregon. 2 *State Tax Guide* (CCH) ¶ 6021 (1989).

as the collection commissions paid to the states by the federal government, could decisively impact the outcome.

VI. THE STATES' INCENTIVES TO ACCEPT THE BURDEN

Why should the states agree to administer the federal tax? This question may be the thorniest of all. At first blush it appears, the states have little advantage in such an agreement. This is particularly true in the case of a national sales tax because many state officials may view the tax as federal poaching on the state tax preserve.⁵⁰ This intrusiveness, however, may ultimately support state assumption of the administration of the federal tax, because if, as has been suggested, the federal tax would place unacceptable compliance burdens on businesses unless it was coordinated in some fashion with state taxes,⁵¹ the only avenue for the states to avoid either federal preemption or forced piggybacking of state sales taxes on the federal sales tax would be combined administration by the states.

Other, more positive, reasons for the states to take on the task of administering the federal tax do exist. First, there is revenue. As is hypothesized here, if the states can collect the federal tax more cheaply than the federal government, there should be room for payment of a collection commission to the states which would allow them a profit.⁵² Assuming the commission is an established percentage of the amount collected, the states would have a profit incentive for active enforcement of the federal tax. In states where the administration espouses the "government should be run as a business" model, this reason could be a particularly tempting aspect of combined administration.

A less tangible incentive for state acceptance of the administra-

⁵⁰ See Carlson, *Economic and Political Aspects of a U.S. Value-Added Tax*, 10 *Tax Notes* 699 (May 12, 1980); McLure, *supra* note 28, at 1530; Treasury Report, *supra* note 7, at 26.

The federal government has levied excise taxes of one kind or another since 1791 (the whiskey tax), but has never levied a general sales tax. For an account of the early history of federal sales taxation, see N. Jacoby, *supra* note 27, at 26.

⁵¹ See McLure, *supra* note 28, at 1530. But cf. Carlson, *Value-Added Tax: Appraisal and Outlook*, 6 *J. Corp. L.* 37, 45 (1980) (suggesting that a federal VAT would not unduly complicate state RST administration and that the two taxes could coexist without coordination even though coordination might be preferable).

⁵² The member states of the European Community receive a ten percent commission for collecting taxes for the European Community other than the VAT.

tive burden for the federal tax would be the element of self-respect of state officials and the question of state pride which might be raised by the refusal to accept the challenge. What state revenue commissioner would want to admit to his governor an inability to do the job? What governor would want to make that same admission to the state electorate?

One may hypothesize that even without these pressures to accept, there may be a number of state administrators who would welcome the opportunity to embark upon such a creative and unusual enterprise. Combined administration is logical and it promises efficiency and coherence. To the extent that there are people in government who care about these things, combined administration has intrinsic appeal.

There is another view of all this, however. Depending on one's perspective, some would argue that combined administration by the states would be a form of vassalage for either the states or the federal government. The view taken on this issue is largely determined by one's view of the roles and relative merits of the state and federal governments. If one accepts the view that cooperative federalism is beneficial and that both the states and the federal government are largely administered by decent and competent people, there is no great reason to fear combined administration. If one believes, for instance, that the federal government is gradually usurping the authority of the states and that this is undesirable, combined administration may be seen as a subtle attempt by the federal government to obtain indirect control of state tax administration.

This article leaves this debate to others, but notes that "the overwhelming difficulties confronting modern society must not be at the mercy of the false antithesis embodied in the shibboleths 'States-Rights' and 'National Supremacy.' We must not deny ourselves new or unfamiliar modes in realizing national ideals."⁵³

VII. THE CONSTITUTIONALITY OF STATE ADMINISTRATION OF A FEDERAL TAX

State administration of a federal sales tax violates no provision

⁵³ Frankfurter & Landis, *The Compact Clause of the Constitution: A Study in Interstate Adjustments*, 34 Yale L.J. 685, 729 (1925).

of the United States Constitution. Indeed, cooperative federalism in the form of interstate compacts predates the Constitution,⁵⁴ and cooperative federalism in one form or another permeates all levels of modern government.⁵⁵ Questioning the validity of combined administration requires questioning the entire revenue sharing matrix of modern federalism. Combined administration involves some grant of authority to the states to control federal property, but federal supremacy is not curtailed thereby.⁵⁶ The combined administration by the states may be viewed in the same light as the performance of a governmental function by a private contractor.⁵⁷ Although there may be limits placed on the authority that may be delegated, within those limits the authority to delegate is plenary.

Nevertheless, it must be recognized that constitutional questions could be raised by combined administration. For instance, an argu-

⁵⁴ See Frohnmayer, *The Compact Clause, the Appointments Clause and the New Cooperative Federalism: The Accommodation of Constitutional Values in the Northwest Power Act*, 17 *Envtl. L.* 767, 770 (1987). This article provides an interesting analysis of *Seattle Master Builders Ass'n v. Pacific Northwest Elec. Power and Conservation Planning Council*, 786 F.2d 1359 (9th Cir. 1986), cert. denied, 479 U.S. 1059 (1987). In that case, the Ninth Circuit saved a regional federal/state compact from a challenge to its constitutionality based on the Compact Clause and the Appointments Clause of the Constitution.

The Frohnmayer article makes favorable reference to Frankfurter & Landis, *supra* note 53, as a further source for those interested in knowing more about the Compact Clause.

⁵⁵ See Frohnmayer, *supra* note 54, at 770, 781-82. Frohnmayer favors a flexible and creative approach to federalism which adapts to changing circumstances and needs and which abjures formalistic requirements:

The intriguing issues of federalism on the level of abstract theory may obscure three obvious, practical points. First, the federalist theory—seen as the geographical division of legally shared governmental authority—was essential to the framing and ratification of the Constitution (citations omitted). Unless federalism is accommodated at some level, we wrench all meaning from the structural underpinnings of our fundamental law. Second—seen as a concept of shared national and state sovereignty—federalism works daily, and works well, in thousands of arenas of governmental action throughout fifty state jurisdictions. And, third, the very flexibility of the concepts of federalism makes these ideas susceptible to new applications to solve otherwise intractable governmental problems.

Id. at 770.

⁵⁶ See Goble, *The Council and the Constitution: An Article on the Constitutionality of the Northwest Power Planning Council*, 1 *J. Env'tl. L. and Litig.* 11, 29-64 (1986). This article puts to rest the various constitutional arguments which might be raised as foils to this conclusion.

⁵⁷ The use of private contractors to produce materials for defense, to provide technical expertise, to perform research, and to perform a multitude of other important functions on behalf of the government is of such longstanding duration and wide acceptance as to be beyond question.

ment might be made that combined administration violates the Uniformity Clause.⁵⁸ This provision requires geographical uniformity in the application of a federal tax.⁵⁹ Because some administrators of the tax are state officials rather than federal officials, it could be argued that a system of combined administration would be inherently lacking in uniformity. However, it is difficult to conceive that this argument would prevail in court⁶⁰ because all policymaking functions with respect to the federal tax would remain with federal officials.⁶¹ While the danger of non-uniformity may be greater under a combined administration regime than under a purely federal administration regime, there is no inherent reason why combined administration must be non-uniform. Moreover, even a federal regime would necessarily employ agents whose authority would be subject to geographical limitations smaller than the entire United States. Such limitations clearly would not violate the Uniformity Clause, so logically the use of state rather than federal officials to administer the federal tax is an irrelevant distinction because in both cases the tax would be based on a uniform federal law implemented at the policy level by federal officials.

Another constitutional issue which might be raised is whether state administration of a federal tax violates the Appointments Clause.⁶² This provision sets out the method by which federal "Officers" must be appointed and provides generally that they must

⁵⁸ See U.S. Const. art. I, § 8, cl. 1. This provision provides: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." *Id.*

⁵⁹ See *Knowlton v. Moore*, 178 U.S. 41, 53 (1900).

⁶⁰ It is worth noting that the Uniformity Clause is not given a rigid meaning. For instance, a number of cases have held that differences in state law which permissibly affect the operation and incidence of a federal taxing statute do not render the federal law non-uniform within the meaning of the Constitution. See, e.g., *Fernandez v. Wiener*, 326 U.S. 340, 359-361 (1945), *reh'g. denied*, 327 U.S. 814; *Poe v. Seaborn*, 282 U.S. 101, 117-118 (1930); *B.F. Sturtevant Co. v. Commissioner*, 75 F.2d 316, 318-319 (1st Cir. 1930).

⁶¹ See text following *supra* notes 5-6.

⁶² See U.S. Const. art. II, § 2, cl. 2. This provision provides:

[The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Id.

be appointed by the President, the courts, or the heads of the Executive departments. The Appointments Clause is one embodiment of the principle of separation of legislative, executive, and judicial powers. Because combined administration is no threat to separation of powers concerns, it seems unlikely that it would impinge on constitutional requirements.

In *Buckley v. Valeo*,⁶³ the Supreme Court ruled that the term "Officers" as employed in the Appointments Clause includes "all persons who can be said to hold an office under the government"⁶⁴ and that the term is intended to have a substantive meaning.⁶⁵ The Court went on to say, "[w]e think [the clause's] fair import is that any appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States.'"⁶⁶ Finally, the Court ruled that federal officers appointed in a manner not countenanced by the Appointments Clause lacked the authority to carry out their assigned functions.⁶⁷

Applying the *Buckley* principles to combined administration, it might be contended that the state revenue officials responsible for collecting the federal tax are de facto federal officers who have not been appointed in compliance with the Appointments Clause⁶⁸ and, consequently, such officials would have no authority to perform the role assigned to them.

In order to scotch, if not kill, this snake it is necessary first to look more closely at the *Buckley* case. The *Buckley* decision involved challenges to the Federal Election Campaign Act of 1971, a wide-ranging piece of election reform legislation.⁶⁹ The Act established a Federal Election Commission ("Commission") to administer and enforce the legislation.⁷⁰ The members of the Commission consisted of two appointees of the President pro tempore of the Senate, two appointees of the Speaker of the House, and two appointees of the President.⁷¹ Under the Act, the Commission pos-

⁶³ 424 U.S. 1, 125-126 (1976).

⁶⁴ Id. at 125-26 (quoting *United States v. Germaine*, 99 U.S. 508, 509-10 (1879)).

⁶⁵ See id.

⁶⁶ Id. at 126 (emphasis added).

⁶⁷ Id. at 126, 138-39, 140.

⁶⁸ In effect, the state collection officials could be said to have been appointed by Congress when Congress authorized collection of the federal tax by the states.

⁶⁹ See *Buckley*, 424 U.S. at 6-7.

⁷⁰ Id. at 7, 109.

⁷¹ Id. at 113. The two presidential appointees had to be confirmed by both the House and

sessed "extensive rulemaking and adjudicative powers" to carry out the purposes and provisions of the Act.⁷² The challenge to the Commission rested on the implicit violation of the principle of separation of powers arising from Congress vesting in itself the authority to appoint the persons who would exercise the Commission's powers.⁷³ The principle of separation of powers was given definite shape in the *Buckley* context by the Appointments Clause's grant of primary authority to the President to appoint federal officers.⁷⁴ As stated previously, the Court held that the Appointments Clause was violated because the members of the Commission were "Officers of the United States" whose appointments were not carried out in a manner conforming to that provision's requirements.⁷⁵

The ruling that the Commissioners were "Officers of the United States" rested on facile analogies to other federal employees who had been found to be "Officers of the United States."⁷⁶ The Court made no effort to connect those analogies with its earlier statement that "any appointee exercising significant authority" under federal law must be appointed in conformity with the Appointments Clause. In a footnote, however, the Court recognized that not all employees of the United States rise to the status of officers.⁷⁷ The Court stated, "[e]mployees are lesser functionaries subordinate to officers of the United States,"⁷⁸ and it went on to contrast that definition with the fact that "the Commissioners . . . are not subject to the control or direction of any other executive, judicial, or legislative authority."⁷⁹ In this manner the Court made it clear

the Senate, a more stringent requirement than the Appointments Clause. *Id.* at 126. For the text of the Appointments Clause, see *supra* note 62.

⁷² See *Buckley*, 424 U.S. at 110.

⁷³ *Id.* at 118-19.

⁷⁴ *Id.* See also *supra* note 62 for the text of the Appointments Clause.

⁷⁵ *Buckley*, 424 U.S. at 140-41. Even the President's appointments of the two members of the Commission did not conform to the requirements of the Appointments Clause because their appointments had to be confirmed by both the House and Senate. *Id.* at 126.

⁷⁶ See *id.* The Court noted that postmasters first class and court clerks previously had been held to be inferior officers of the United States within the meaning of the Appointments Clause and then concluded that "surely the Commissioners before us are at the very least such 'inferior Officers' within the meaning of that Clause." *Id.*

⁷⁷ *Id.* at 126 n.162.

⁷⁸ *Id.* (citing *Auffmordt v. Hedden*, 137 U.S. 310, 327 (1890); *United States v. Germaine*, 99 U.S. 508 (1879)).

⁷⁹ *Id.*

that the Commissioners could not conceivably qualify as mere federal employees.

The state revenue officials charged with collecting the federal tax under a combined administration regime would differ markedly from the Commissioners in *Buckley*. First, state revenue officials are neither appointed by Congress nor compensated by the federal government. They are state officers. Second, in the context of their federal tax collection role, they would operate under the direction of "Officers of the United States" appointed in compliance with the Appointments Clause. In this sense they would resemble federal employees. Third, uncertainty exists as to whether the state officials would constitute "appointees" for federal constitutional purposes and, if so, whether they would exercise "significant authority" under federal law.

From a policy perspective, there is no reason to extend the *Buckley* holding to the state revenue officials in a combined administration regime because separation of powers is not implicated.⁸⁰ There is no hint of Congress reserving for itself the power to appoint those charged with enforcing the laws it enacts with regard to combined administration. The separation of powers principle is founded upon a fear of the tyranny which might result from a concentration of legislative and executive powers in a single person or group of persons.⁸¹ A combined administration regime retains the traditional division of powers among the three branches of the federal government while some of the ministerial functions assigned to the Executive are carried out by state executive officers acting under the direction of federal executive officers. Thus, combined administration poses no threat to the liberty of the public at large nor does it impinge upon the independence of any branch of government.

One way to view state officials in the combined administration context is to consider them employees of an independent contractor retained by the federal government to perform a service relating to the operation of the government. Some of the nation's most

⁸⁰ In this context the principle of separation of powers referred to is the principle of separation of the powers of the federal government into the three branches: executive, legislative, and judicial. Clearly, there is a delegation to some extent of federal power to the states. As will be discussed in the text accompanying *infra* notes 82-85, this is more readily addressed as the use of an independent contractor to perform a governmental function.

⁸¹ See *Bowsher v. Synar*, 478 U.S. 714, 721-22 (1986); *Buckley*, 424 U.S. at 120-21.

expensive and sensitive tasks have been undertaken in this fashion. For instance, government-owned nuclear energy facilities in several states are operated by private corporations under government contracts and have been operated in this manner since the earliest days in the development of atomic energy.⁸² It is questionable whether a distinction should be drawn between such privately contracted governmental activities and the collection of taxes on the grounds that tax collection is inherently a governmental function and should be non-delegable.⁸³ But if only federal employees were authorized to collect taxes, requirements that private employers withhold and remit the income taxes owed by their employees would seem to be impermissible. Such withholding is required by statute⁸⁴ and has been upheld as constitutional.⁸⁵ Thus, tax collection appears to be a delegable governmental function.

Other constitutional challenges to combined administration could be formulated, but the likelihood of their success must be considered highly doubtful. In an era where the operations of our state and national governments have become so intertwined, combined administration hardly seems revolutionary. Conversely, in order to treat combined administration as unconstitutional, the courts would necessarily endanger many other mechanisms of co-

⁸² For a description of this arrangement, see *United States v. New Mexico*, 455 U.S. 720, 722-27 (1982). For a contemporaneous account of the development of this phenomena, see Newman, *The Atomic Energy Industry: An Experiment in Hybridization*, 60 *Yale L.J.* 1263 (1951).

⁸³ In support of this contention one might cite the Federal Acquisitions Regulation System which forbids government agencies from awarding a contract "for the performance of an inherently governmental function" in its regulations. See 48 C.F.R. § 37.102(b) (1988).

⁸⁴ See I.R.C. § 3402.

⁸⁵ See *United States v. Smith*, 484 F.2d 8 (10th Cir. 1973), cert. denied, 415 U.S. 978 (1974); *Abney v. Campbell*, 105 F. Supp. 740 (N.D.Tex. 1952), aff'd., 206 F.2d 836 (5th Cir. 1953), cert. denied, 346 U.S. 924 (1954).

In *United States v. American Friends Serv. Comm.*, 419 U.S. 7 (1974), the Supreme Court avoided the issue by ruling that the Anti-Injunction Act (26 U.S.C. § 7421(a) (1954)) prevented the plaintiffs from enjoining collection of the tax from their employer because they could not come within the exception provided by earlier cases. The immediate issue raised by the plaintiffs who were Quakers, was whether their First Amendment right of freedom of religion entitled them to require the government to levy against them in order to obtain the portion of their income taxes they asserted was dedicated to military purposes. *Id.* at 8. Because it was conceded that the plaintiffs would ultimately be required to pay the taxes, no basis for granting an injunction was found. *Id.* at 10. Justice Douglas, in dissent, would have granted the injunction as a means of allowing the plaintiffs to bear witness to their constitutionally protected religious beliefs. *Id.* at 13 (Douglas, J. dissenting).

operative federalism. No compelling policy arguments for such an approach are readily apparent.

VIII. COMBINED ADMINISTRATION AND INTERSTATE SALES

Combined administration in the context of interstate sales presents both complexities and opportunities. The complexities arise from the circumscription of state taxation of interstate sales by federal constitutional constraints and practical considerations. The opportunities arise from the new resources that combined administration might provide for addressing those constraints and considerations.

A controlling principle in interstate sales taxation in the United States is the "Destination Principle."⁸⁶ The Destination Principle dictates that when goods are sold in interstate commerce, the sales tax applicable to the transaction is that of the state of destination rather than the sales tax of the state of origin.⁸⁷ This assumes a true interstate sale in which goods are shipped from the state of origin, but where title or possession passes to the buyer in the state of destination. For sales tax purposes, a sale is intrastate if it is completed in the seller's state of residence even though the purchase may have been made for the purpose of using the goods in another state.⁸⁸

The Destination Principle may be seen as a natural concomitant to the limits of state sovereignty. Sales which take place beyond the state's border are beyond the state's ability to tax;⁸⁹ so an obvious tax incentive is created for residents in sales tax states to make their purchases in non-sales tax states. This illustrates the need for

⁸⁶ This term is used because it has a certain universal meaning. See B. Terra, *supra* note 17, at 13. In a broad context the Destination Principle taxes goods where they are consumed. *Id.* It is employed in the European Community VAT system. *Id.* at 95. Whether a product is "consumed" in one state or another may be a close question, but in this context "consumed" simply refers to the place where the taxable event takes place. Terra's discussion of the concept of "consumption" gives it a meaning which is quite compatible with our method of levying sales taxes in the state where the transaction is completed. See *id.* at chs. II.3 & II.4.

⁸⁷ The reverse of the Destination Principle is aptly referred to as the Origin Principle.

⁸⁸ *Utah Tax Comm'n v. Pacific States Cast Iron Pipe Co.*, 372 U.S. 605 (1963); *International Harvester Co. v. Department of Treasury*, 322 U.S. 340 (1944). This comports with the meaning of "consumption" in sales tax law. See *supra* note 86.

⁸⁹ This view is subject to challenge, however. See *infra* notes 106-07 and accompanying text.

a use tax as an enforcement mechanism for the sales tax.⁹⁰ The importance of the use tax has diminished as sales taxes have become more prevalent, because most states allow a credit against their use tax for sales taxes properly paid to another state.⁹¹ Thus, if a taxpayer makes a purchase in a state with a four percent sales tax and brings the item into a state which levies a five percent sales and use tax, he is liable only for the one percent difference in rate between the first state's sales tax and the second state's use tax. The utility of the use tax has always been severely circumscribed by the practical difficulties of administering it, but *National Bellas Hess v. Department of Revenue of Illinois*⁹² served to greatly enhance those practical difficulties.

In *National Bellas Hess*, the Supreme Court ruled that Illinois lacked the authority to require an out-of-state company to collect Illinois use tax on a mail order sale to an Illinois resident, because the company had insufficient contacts with the state. Whether Congress has the power to overturn the Court's decision is a matter of some debate.⁹³ This debate stems from the ambiguous wording of the Court's opinion⁹⁴ which is unclear as to whether the Court's result rested on the Due Process Clause⁹⁵ or the Commerce Clause.⁹⁶ If the decision rested on the former clause, then presuma-

⁹⁰ See J. Due & J. Mikesell, *supra* note 16, at 245.

⁹¹ See *id.* at 247.

⁹² 386 U.S. 753 (1967).

⁹³ See, *eg.*, Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 100th Cong., 2nd Sess. 75-76, 143-44 (1988) (statement of Lucas A. Powe, Jr., Professor of Law University of Texas and statement of Jerome Hellerstein, Adjunct Professor, New York University School of Law).

⁹⁴ In the Court's majority opinion, Justice Stewart stated that "the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a State's compliance with the requirements of due process in this area are similar." *National Bellas Hess*, 386 U.S. at 756.

The Court further discussed the facts of the case in relation both to due process and interstate commerce principles without ever specifying the ultimate foundation for the result reached. In the end, however, the Court implied that Congress possessed the authority to change the result when it stated that "[t]he very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control." *Id.* at 760.

⁹⁵ U.S. Const. amend. XIV, § 1.

⁹⁶ U.S. Const. art. I, § 8, cl. 2.

bly Congress is powerless to change the result; but if the decision rested on the Commerce Clause, then Congress's authority to regulate interstate commerce is sufficient to overrule the result in *National Bellas Hess*.⁹⁷ It should be noted that recently the Supreme Court has indicated that *National Bellas Hess* rested on the Commerce Clause.⁹⁸

If the ruling paradigm in state taxation of interstate sales is the Destination Principle, then *National Bellas Hess* must be seen as aberrational.⁹⁹ The act of completing the sale in the state of destination (even if only by means of a common carrier or the postal authorities) should be seen as a sufficient basis to hold the seller liable for collecting either the sales or the use tax applicable to the transaction so long as the tax applies in a non-discriminatory fashion. Under such a principle, all sales completed within a state would be treated equally. The *National Bellas Hess* decision provides out-of-state mail order companies with an unfair competitive advantage vis-a-vis in-state retailers.

The states have demonstrated a strong interest in seeing the *National Bellas Hess* decision overturned,¹⁰⁰ because it is extremely

⁹⁷ Much has been written about the *National Bellas Hess* decision. For a recent analysis which suggests that cases subsequent to *National Bellas Hess* have greatly reduced its significance, see Pearson & Schmidt, Why States Can Circumvent *National Bellas Hess* and Collect Use Taxes From Most Mail Order Houses, 7 J. of State Tax'n 243 (1988).

For a discussion of nexus requirements under the Due Process Clause and the Commerce Clause, see Nagel, The Emergence of a Single Nexus Standard, 45 Tax Notes 327 (Oct. 16, 1989).

⁹⁸ D. H. Holmes Co. v. McNamara, 486 U.S. 24 (1988).

⁹⁹ There are two reported trends in state taxation of mail order sales which are worthy of mention. The first trend is the recent formation of several regional compacts by the states to share information and to otherwise assist one another in the collection of use taxes owed on mail order sales. The second trend is a wave of state legislative enactments intended to extend sales tax nexus to out-of-state companies who have established some form of economic presence within the state. See Supporters of Brooks' Mail-Order Sales Tax Bill Rally, 43 Tax Notes 784, 785 (May 15, 1989) [hereinafter Sales Tax Bill].

Of course, the nexus issue was at the heart of the Court's decision in *National Bellas Hess*. For a discussion of the nexus requirement implicit in the Commerce and Due Process Clauses, see Jurinski, Agency Relationships in Determining Nexus: Groping for a Solution, 7 J. of State Tax'n 321 (1989). See also Nagel, supra note 97.

¹⁰⁰ Legislation designed to change the nexus definition reported in *National Bellas Hess* is estimated to grant the states over \$1.5 billion in lost annual revenues. See State Taxes: Progress Reported in Negotiations on Mail Order Sales Tax Bill, Daily Tax Rep. (BNA) at G-3, G-4 (Mar. 1, 1988). Initially, local governments objected to the proposed federal legislation because they believed that the legislation would permit approximately \$500 million in sales taxes to remain uncollected at the local level. See Sales Tax Bill, supra note 99, at 784.

impractical for the states to collect the use tax on mail order sales directly from consumers. This impracticality stems from the fact that needed assessment information is not readily available to the states,¹⁰¹ and even if it were available, a great deal of administrative inconvenience would exist to collect the usually small tax liabilities from such a large pool of taxpayers.

If Congress has the authority to overturn *National Bellas Hess*, then the question of the impact of combined administration on the states' ability to collect use taxes from mail order companies is largely political.¹⁰² Presumably, if Congress elected to enter into a combined administration compact with the states, Congress would also grant the states authority to collect use taxes from mail order houses at the same time they collect the federal tax. Such a grant would reflect a sense of comity on Congress's part which might prove valuable in enticing the states into the combined administration compact.

If Congress lacks the power to overturn *National Bellas Hess*, combined administration would most likely not alter the legal status quo, but is likely to have the practical effect of encouraging voluntary remittance of state use taxes by mail order companies because mail-order companies would be subject to audit by state revenue agencies as part of the federal tax collection system. Thus the states would be privy to the information they need in order to enforce the use tax directly against consumers.¹⁰³ Rather than subject their customers to the indignity and inconvenience of a use tax assessment, many mail-order companies might choose to collect

¹⁰¹ The same barrier which prevents the states from collecting the tax from the mail order companies also prevents them from auditing the mail order houses' records. The statute in issue in *National Bellas Hess* not only imposed an obligation to collect and remit the Illinois use tax, it also required recordkeeping and submission to necessary "investigations, hearings, and examinations." *National Bellas Hess*, 386 U.S. at 755. Although the opinion did not specify, it seems clear that when the Court released *National Bellas Hess* from the obligation to collect the tax, the Court also released *National Bellas Hess* from the other burdens imposed by the statute in issue.

¹⁰² Recently, there have been several bills pending before the House which seek to overturn *National Bellas Hess*. See House Judiciary Subcommittee Considers Mail-Order Sales Tax Bills, 39 Tax Notes 19 (April 4, 1988). Such legislation was again introduced on May 4, 1989. See Sales Tax Bill, *supra* note 99, at 784.

¹⁰³ One might question whether the states would or should be free to use that information for any purpose other than collection of the federal tax. The states and the federal government currently have contractual agreements for sharing tax information which place various confidentiality requirements upon the dissemination of the information obtained.

and remit the tax themselves.

Whether one employs the Origin Principle or the Destination Principle to interstate sales is legally irrelevant for federal sales tax purposes, because those sales take place within a single taxing jurisdiction, i.e., the United States. Only in the area of imports and exports does it matter which principle is employed, and the Destination Principle is the logical standard to adopt because it frees exports from taxation and taxes imports at a rate equivalent to the rate on competing domestic goods. The external neutrality created by avoiding competitive distortions is generally regarded as a major virtue of the Destination Principle.¹⁰⁴ Thus, constitutional considerations aside, the Destination Principle makes sense for purposes of state sales taxation.¹⁰⁵

In a system of combined administration by the states, an administrative issue exists with respect to collection of the federal tax on interstate sales. It would be more efficient to have the federal tax collected by the revenue agency in the seller's domiciliary state. Otherwise, the seller would be required to remit various parts of its total federal sales tax liability to as many as fifty different collecting points. Assuming that *National Bellas Hess* can be overruled, a logical corollary to such an approach would be to have each origin state act as a clearinghouse for the other states with respect to use taxes owing to the various destination states on mail order sales originating within its boundaries. Thus, all state and federal sales and use tax auditing and collection with respect to a given interstate retailer could be handled by the state revenue agency with the most immediate jurisdiction over that retailer.

If *National Bellas Hess* cannot be overruled, then the states in which the mail order companies reside could attempt to apply their own sales taxes to interstate sales.¹⁰⁶ It would be anomalous if

¹⁰⁴ See B. Terra, *supra* note 17, at 18-19, 100-01. A RST is also neutral in its impact on *internal* competition as compared to a cumulative, multistage sales tax because the RST falls equally upon goods produced under integrated and non-integrated conditions. *Id.* See also A. Robinson, *supra* note 5, at 33-34. However, because not all purchases by entrepreneurs are exempt from most RST's, some cascading of tax does occur.

¹⁰⁵ For an analysis of the applicability of the Destination Principle in a federal VAT context, see Cnossen, *The Irrelevance of the Restricted Origin Principle*, 20 *Tax Notes* 521 (Nov. 7, 1983).

¹⁰⁶ See Baccash, *Sales Taxation of Interstate Commerce—Can a State Constitutionally Levy Its Sales Tax on an "Interstate Sale?"*, 3 *Inst. on St. and Loc. Tax'n* § 1.01, § 1.01, 1-5 (1983). Baccash contends that application of the four prong test in *Complete Auto Transit*,

one class of retail sales were immune from sales taxation in both the state of origin and the state of destination.¹⁰⁷ Even so, application of the Origin Principle is undesirable because it invites competitive distortions and conflicts with the essential nature of the sales tax as a tax upon consumption.

Resolution of the mail order sales problem is not essential for combined administration, but such resolution is a desirable end in itself which comports with combined administration. However, combined administration does not offer a constitutionally proven means of eliminating the mail order sales problem, but it does not create any new barriers to a solution. If the mail order sales issue can be resolved to the states' satisfaction, such a solution might dovetail neatly with a combined administration regime regarding interstate sales by placing both federal sales tax and state use tax collection responsibilities upon state revenue agencies in the state where the seller has its principal place of business.

IX. CONCLUSION

The idea of a national sales tax has been considered by governments and academics for many years. Perhaps it always will be nothing more than an idea. If enactment of national sales tax should come about, however, both the revenues and the administration of state sales taxes will be affected. The continuation of sales taxes as the chief revenue source of the states may depend upon the states' ability to accommodate their systems to the federal tax. Combined administration at the state level of both the state and federal taxes represents one possible accommodation.

Combined administration by the states of both their own retail sales taxes and a federal retail sales tax is feasible. The experience of the European Community with a value-added tax has demonstrated this. An agreement among the states and the federal government upon identical tax bases and exemptions would be helpful, but not essential, in such an administrative regime. Even with

Inc. v. Brady, 430 U.S. 274 (1977), will validate taxation of interstate sales by the state of origin if credit is allowed for sales or use tax paid in the state of destination. See Baccash, *supra* note 106, at § 1.04, 1-21 to 1-25.

¹⁰⁷ Of course *National Bellas Hess* involved simply requiring the seller to collect the use tax owed by its buyer, but it is implicit in such an approach that the more direct route of collecting the sales tax from the seller was unavailable to the state.

variations in exemptions and the treatment of services, combined administration should offer significant gains over dual administration in both administrative economy and efficiency as well as in taxpayer compliance costs.

Combined administration in the context of state retail sales taxes and a federal value-added tax would offer less advantages over dual administration in terms of efficiency or economy. Even so, such an approach should not be automatically dismissed. Coordination of the two taxes will be necessary at some level, and combined administration would establish at least the beginnings of such coordination.

In a time when the enormity of government seems a permanent fixture of modern life, it is appropriate and even imperative to seek ways in which to make government operate more efficiently. Intergovernmental cooperation is an important feature of American federalism. With these two principles in mind, combined administration of two very similar taxes makes good sense, even if those taxes are levied by different sovereigns.