

The Sales Tax Dilemma

In our imperfect world, even the most deliberate actions tend to generate a welter of unforeseen consequences...some good, some bad, some insignificant—a tendency referred to as the law of unintended consequences. A counterpart to this law is the fact that nothing is ever as simple as it seems. The prevalence of unforeseen consequences comes to mind as the music industry debates the merits of the “Tax Fairness Bill” currently on the floor of the U.S. Senate.

For the uninitiated, the Tax Fairness Bill would compel mail-order merchants to collect and remit state sales tax on all of their transactions. If the bill passes as currently written, a catalog retailer in California who sells a computer to a resident of New York State (or any other state) would be required by law to collect New York’s 8% sales tax and remit it Albany. The bill has struck a strong and resonant chord with local merchants who are regularly stung by consumers who buy from a catalog to dodge increasingly burdensome sales taxes. “Why should local merchants be penalized by the tax code? We just want a level playing field” is their rallying cry. And at first glance, arguing with their logic is about as difficult as coming out against the concept of tax fairness itself.

Mail-order merchants in and out of the music industry don’t muster much of an argument to counter the bill, either. Strip away the plaintive rhetoric about preserving consumer choice, and their complaints come down to two unabashedly self-interested issues: (1) The bill would adversely affect their sales by increasing their selling prices; and (2) The filing requirements would create an additional administrative burden. To which we respond: tough luck. What is so inherently wonderful about mail order that it should receive favored status? Inasmuch as the salaries of 100,000 public school music educators nationwide are funded to a large degree by state sales taxes, the mail-order retailers’ claim that they “do not receive the benefits of the services funded by out-of-state sales taxes” is also nonsense. Ohio fire departments may not do much to protect Indiana catalog houses, but don’t overlook that Ohio sales-tax-funded educators sure help them sell horns.

While the arguments of mail-order retailers to preserve their tax-exempt status can be dismissed as unadulterated self-interest, we still can not advocate the “Tax Fairness Bill.” In an ideal world it would be wonderful to truly “level the playing field”; however,

given the aforementioned law of unintended consequences, we feel that the “Tax Fairness Bill” would probably do more damage than good.

A central part of any tax bill are the measures to ensure widespread compliance. When the income tax was broadened to include a substantial portion of the population in 1916, Congress was quick to enact employer withholding to make sure that the levy would be paid. Compliance measures in the tax fairness bill have yet to be debated, but we have to assume that they would give states the right to audit the books of out-of-state retailers to ensure that sales tax was being properly collected and paid. Herein lies the hitch. Given the insatiable financial demands of state treasuries nationwide, what is to stop one state treasury from aggressively prosecuting out-of-state businesses for failure to comply with their tax laws? And what politician could resist the opportunity to shake down citizens that they would never have to answer to in an election?

If the issue began and ended with sales tax, we would be more inclined to support the Tax Fairness Bill. But what is at issue is the principle of taxation without representation; should one state be allowed to regulate the commerce of another state? If a state is authorized to collect sales taxes from out-of-state retailers, why then should it not be able to collect income taxes, user fees, and other “revenue enhancements” as well? And don’t think the issue is limited to catalog retailers alone. By our estimate, fully half of the “local retailers” in the nation are within an hour’s drive of a bordering state. If these dealers get their “level playing field,” how will they feel when out-of-state revenue agents show up at their door to see if they can extract any unpaid sales tax?

With inflation heating up during the Korean War in 1952, President Truman enacted strict wage and price controls. As a concession to disgruntled labor unions, the President amended the tax code to let employers deduct the cost of medical coverage for employees. Then the law of unintended consequences took over. Forty years later it’s generally agreed that tax-deductible medical insurance is a major reason for our runaway health care costs. If a minor amendment to the tax code can cause what is generally described as a health care crisis, we shudder to think about what might happen if a major principle like giving states the right to regulate interstate commerce is adopted. Local retailers who want a more level playing field should take up the issue of onerous sales tax with their elected state officials. In the Tax Fairness Bill, they are getting a lot more than they bargained for.

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