

# EMPIRIS LLC

## UNCOLLECTED SALES TAXES ON ELECTRONIC COMMERCE: A REALITY CHECK

by  
**Jeffrey A. Eisenach and Robert E. Litan**

### EXECUTIVE SUMMARY

Under the Supreme Court's 1992 *Quill* decision, online retailers are not required to collect sales taxes in states where they do not have a physical presence, or "nexus." As a result, state and local sales taxes are not collected on some proportion of interstate sales. Since the early days of the Internet, state and local governments have lobbied Congress to overturn *Quill* and force e-retailers to collect taxes on all sales, regardless of whether they have nexus.

The amount of uncollected taxes involved is central to the debate. Overturning *Quill* would impose significant administrative costs, especially on small businesses (where administrative costs account for as much as 13.5 percent of taxes collected), and would have other negative consequences as well. If, the resulting tax collections would be too small to materially affect state and local government finances, then governments arguably should look elsewhere for a solution to their fiscal difficulties.

In this study, we present an estimate of the amount of potential uncollected sales tax revenues for 2008, and a forecast of uncollected revenues through 2012. Our primary findings are:

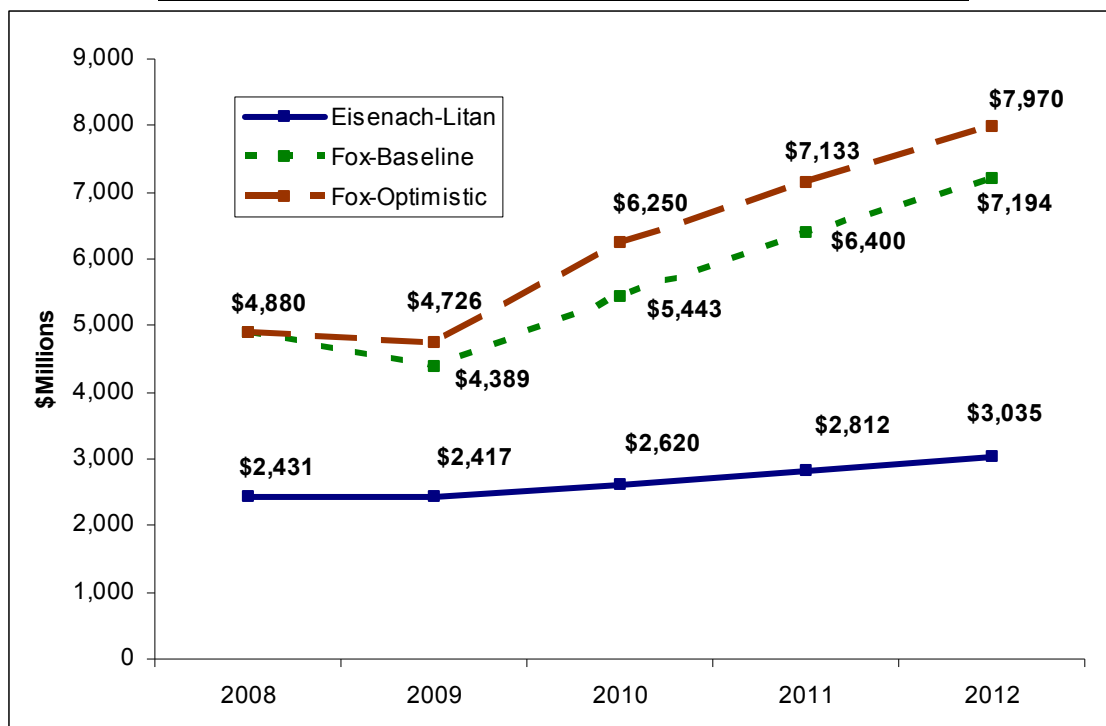
- Total potential uncollected sales tax revenues in 2008 were approximately \$3.9 billion, or less than three-tenths of one percent of state and local tax revenues.
- More than one third of uncollected revenues are associated with small businesses. If firms with less than \$5 million in remote sales were exempt (as proposed by legislation introduced in recent Congresses), potential uncollected revenues fall to approximately \$2.45 billion, or less than two-tenths of one percent of state and local tax revenues.
- Uncollected revenues are not rising rapidly. Uncollected revenues (from firms with more than \$5 million in remote sales) will average approximately \$2.67 billion over the 2008-2012 period, or about two tenths of one percent of total state and local tax revenues.
- The growth of "brick and click" retailing (i.e., brick and mortar retailers with substantial online sales) is likely to reduce the proportion of online sales on which taxes are not collected. In addition, states are using various tactics to promote tax collection by "out-of-state" firms. These two trends suggest that uncollected revenues are likely to fall over time – i.e., that the uncollected revenue problem is "solving itself."
- A few large firms account for the bulk of uncollected tax revenues. For example, the top 10 firms (ranked by uncollected taxes) account for approximately 47 percent of total uncollected revenues. This finding provides some support for those who have argued that the states should focus their efforts on firms with large uncollected tax revenues.

Our findings differ markedly from those of a recent study by a group at the University of Tennessee (the *Fox Study*), which estimated uncollected tax revenues associated with *Quill* at over \$7.7 billion in 2008, rising to as much as \$12.7 billion in 2012. The differences can be attributed to three primary factors:

- First, the *Fox Study* substantially overstates uncollected taxes associated with business-to-business (B2B) online sales.
- Second, the *Fox Study* understates tax collections by small firms.
- Third, with respect to “out-year” projections, the *Fox Study* assumes an unrealistically high and unsustainable growth rate for online sales, especially considering the fact that the growth of broadband penetration among U.S. households – one of the primary drivers of online sales growth – is slowing as household broadband penetration approaches saturation.

The differences between our results and those of the *Fox Study* are summarized in the figure below. In our view, the most significant difference is in the rates of growth: Rather than growing rapidly, as the *Fox Study* suggests, our analysis demonstrates that uncollected revenues are, at most, growing slowly. Given that uncollected revenues account for such a small proportion of revenues, our assessment is that state and local tax collectors would be best served by focusing their efforts on other potential revenue sources.

**POTENTIAL UNCOLLECTED REVENUE FORECASTS, 2008-2012**



**TABLE A-1:**  
**STATE-BY-STATE ESTIMATES OF POTENTIAL UNCOLLECTED REVENUES**  
**(\$MILLIONS, 2008, 2012)**

State	2008			2012		
	Fox (baseline)	Eisenach-Litan	Eisenach-Litan with SBE	Fox (baseline)	Eisenach-Litan	Eisenach-Litan with SBE
Alabama	\$115.5	\$75.3	\$46.8	\$170.4	\$92.8	\$57.8
Alaska	\$1.0	\$3.6	\$2.0	\$1.5	\$4.4	\$2.4
Arizona	\$250.8	\$79.3	\$49.5	\$369.8	\$97.8	\$61.1
Arkansas	\$77.2	\$49.6	\$30.6	\$113.9	\$61.2	\$37.7
California	\$1,291.6	\$503.9	\$316.1	\$1,904.5	\$621.4	\$389.8
Colorado	\$117.1	\$67.8	\$42.4	\$172.7	\$83.6	\$52.2
Connecticut	\$43.2	\$48.2	\$30.1	\$63.8	\$59.4	\$37.1
DC	\$24.1	\$3.5	\$2.2	\$35.5	\$4.4	\$2.7
Florida	\$545.1	\$227.7	\$142.9	\$803.8	\$280.8	\$176.2
Georgia	\$278.2	\$117.2	\$73.5	\$410.3	\$144.5	\$90.6
Hawaii	\$40.7	\$16.2	\$9.6	\$60.0	\$19.9	\$11.8
Idaho	\$31.4	\$17.8	\$11.1	\$46.4	\$21.9	\$13.7
Illinois	\$343.7	\$196.1	\$123.0	\$506.8	\$241.8	\$151.7
Indiana	\$132.5	\$95.9	\$59.9	\$195.3	\$118.2	\$73.8
Iowa	\$60.1	\$48.7	\$30.1	\$88.7	\$60.1	\$37.1
Kansas	\$96.9	\$29.5	\$18.4	\$142.9	\$36.3	\$22.6
Kentucky	\$74.6	\$36.0	\$22.4	\$109.9	\$44.4	\$27.6
Louisiana	\$268.5	\$95.9	\$60.1	\$395.9	\$118.2	\$74.1
Maine	\$21.7	\$18.3	\$11.2	\$32.1	\$22.6	\$13.8
Maryland	\$124.9	\$69.4	\$43.5	\$184.1	\$85.6	\$53.6
Mass.	\$89.0	\$87.9	\$55.1	\$131.3	\$108.4	\$68.0
Michigan	\$96.0	\$134.0	\$83.9	\$141.5	\$165.2	\$103.4
Minnesota	\$159.6	\$86.2	\$54.0	\$235.3	\$106.2	\$66.5
Miss.	\$91.5	\$40.6	\$24.9	\$134.9	\$50.1	\$30.8
Missouri	\$142.9	\$87.6	\$54.7	\$210.7	\$108.0	\$67.4
Nebraska	\$41.6	\$28.5	\$17.5	\$61.3	\$35.1	\$21.6
Nevada	\$114.6	\$40.6	\$25.4	\$168.9	\$50.0	\$31.3
New Jersey	\$137.3	\$123.0	\$77.0	\$202.5	\$151.7	\$94.9
New Mexico	\$81.7	\$26.4	\$16.5	\$120.5	\$32.6	\$20.3
New York	\$586.9	\$135.3	\$84.8	\$865.5	\$166.8	\$104.6
N. Carolina	\$145.0	\$112.4	\$70.2	\$213.8	\$138.6	\$86.6
N. Dakota	\$10.4	\$9.0	\$5.5	\$15.3	\$11.1	\$6.7
Ohio	\$208.8	\$156.1	\$97.7	\$307.9	\$192.5	\$120.4
Oklahoma	\$95.5	\$60.4	\$37.4	\$140.8	\$74.5	\$46.1
Pennsylvania	\$234.6	\$157.0	\$98.5	\$345.9	\$193.6	\$121.4
Rhode Island	\$19.7	\$16.8	\$10.5	\$29.0	\$20.7	\$12.9
S. Carolina	\$84.5	\$63.6	\$39.7	\$124.5	\$78.4	\$49.0
S. Dakota	\$20.2	\$13.2	\$8.1	\$29.8	\$16.2	\$10.0
Tennessee	\$278.6	\$105.1	\$65.7	\$410.8	\$129.6	\$81.0
Texas	\$590.3	\$319.6	\$200.4	\$870.4	\$394.1	\$247.2
Utah	\$60.0	\$35.3	\$21.8	\$88.5	\$43.5	\$26.8
Vermont	\$17.0	\$11.3	\$6.8	\$25.1	\$13.9	\$8.3
Virginia	\$140.4	\$71.9	\$45.1	\$207.0	\$88.7	\$55.6
Washington	\$191.2	\$78.3	\$49.1	\$281.9	\$96.5	\$60.6
W. Virginia	\$34.3	\$24.2	\$14.8	\$50.6	\$29.9	\$18.3
Wisconsin	\$96.4	\$66.9	\$41.9	\$142.1	\$82.5	\$51.7
Wyoming	\$19.4	\$7.9	\$4.8	\$28.6	\$9.8	\$5.9