



LOCALLY ADMINISTERED SALES AND USE TAXES

A REPORT PREPARED FOR THE INSTITUTE FOR
PROFESSIONALS IN TAXATION

PART III: OPTIONS FOR REDUCING COSTS RELATED TO
LOCALLY ADMINISTERED SALES AND USE TAXES

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Options for Reducing Costs Related to
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Introduction

Part III of the report identifies options that state and local governments could consider to reduce the costs imposed on businesses and governments to comply with and administer locally administered sales taxes. The options are based on the research conducted for this report, the literature addressing local sales taxes and their administration, and proposals made in the past by various organizations that have examined local sales tax administration and compliance. The options put forth here should not be construed to constitute recommendations being offered by KPMG LLP for action by state or local governments. They are, instead, alternatives that could, if adopted, reduce the costs of complying with and administering locally administered sales taxes to varying degrees, based on the analysis conducted for this report.¹

The options described here are generally applicable to both general sales and use taxes as well as the specialty lodging, food and beverage, and amusement taxes examined in this report unless otherwise specified. That is, the options should be generally applicable regardless of the type of locally administered transaction tax involved. Where the discussion includes estimated cost savings that could be achieved through adoption of a particular option, the estimated savings are based on the analysis of the surveys of taxpayers and local governments presented in Part II of the report. The surveys gathered data on costs incurred in complying with and administering only general sales taxes and not the specialty taxes. Therefore, references to potential cost savings reflect savings attributable only to the implementation of the option for general sales taxes; any savings from applying the option to the specialty taxes would be in addition to the stated estimate.

¹ As noted in Part I, all conclusions in this report were reached using a “more likely than not” standard. For ease of understanding and as a stylistic matter, language such as “will” or “should” that could suggest we reached a conclusion on an issue at a standard different from “more likely than not.” Such language should not be so construed.

Summary of Options

Briefly summarized, the options for reducing local sales tax compliance and administration costs that are reviewed below include:

- Improve the availability of information on locally administered sales taxes by requiring that regularly updated information on (a) which localities self-administer their sales taxes, (b) the rates at which the taxes are imposed, (c) the tax base and administrative procedures for the taxes, and (d) contact information for local administrators be available electronically from a centralized source in each state;
- Improve the degree of conformity between state and local sales taxes by requiring that the tax base and administrative procedures for locally administered taxes be consistent with the state sales tax base and procedures or limiting the areas in which local tax bases and procedures may differ from the state base and procedures as well as requiring that information on any such differences be regularly updated and available electronically from a centralized source in each state;
- Require that all locally administered sales taxes be administered instead by the state tax administration agency; and
- Simplify the rate structure for local sales taxes by establishing a single, state-wide rate attributable to all jurisdictions and not require sourcing of transactions to jurisdictions below the state level or otherwise limiting the degree of rate variation and required sourcing of transactions to local jurisdictions by authorizing different local tax rates at only the county or parish level.

Each option would have a different impact on sales tax compliance and administrative costs as outlined below. These options have to a considerable extent been offered by other groups that have examined state and local sales tax compliance and administration in the past, particularly by those groups examining the conditions under which states should be authorized to impose sales and use tax collection obligations on entities that are not obligated under current law to collect tax on sales into a state or locality

Availability of Information

The research conducted for this project revealed a number of states in which we were unable to locate a central source of regularly updated information that identifies which jurisdictions impose locally administered taxes and the rates at which they are imposed, much less details regarding the base of the local taxes, the manner in which they are administered by the various jurisdictions, or other important administrative and procedural information. The lack of information on locally administered taxes is problematic for taxpayers wishing to comply. Before they can develop a system for complying with the locally administered tax in each jurisdiction in which they have a collection obligation, affected taxpayers may need to make a significant effort to identify the jurisdictions that actually impose the tax and gather the state authorizing statutes and local ordinances governing the tax so they can determine what is actually necessary to comply.²

Even for locally administered general sales taxes where one might expect the information necessary for compliance to be reasonably available given the number and variety of taxpayers involved, there are definite gaps. The Idaho Tax Commission maintains only a listing of local jurisdictions imposing a general sales tax, but provides no further information. In Alaska, the only information centrally available on locally administered general sales taxes is an annual compilation of the jurisdictions imposing a sales tax and the rate at which it is imposed. In Colorado³ and Louisiana, the state tax administration agency maintains an up-to-date listing of the localities that self-administer their general sales tax and the rates at which they are imposed, but little or no information on local sales tax bases or procedures. The lack of available information is more prevalent in the states authorizing locally administered lodging, food and beverage, and amusement taxes.⁴ With respect to the specialty taxes identified in Table 4 of Part I, we were unable to locate a central, regularly updated information source identifying the jurisdictions imposing a locally administered tax and the rate at which the tax is imposed in eight of the 21

² While it is true that entities subject to local lodging, food and beverage and amusement taxes are likely to have a physical retail establishment in the jurisdictions in which they are subject to tax, certain companies that are subject to these taxes in a number of jurisdictions manage their sales tax compliance on a company-wide basis. For these companies, an updated, central information source on which jurisdictions impose a locally administered tax would ease the task of compliance.

³ The Colorado Department of Revenue does maintain a list of the choices that statutory cities and other local governments for which the Department administers the tax have made from among the various state exemptions to which they may choose to conform.

⁴ For a listing, *see* Part I, Table 4, p. 17.

states authorizing locally administered lodging taxes, three of the eight states authorizing locally administered food and beverage taxes, and three of the seven states authorizing locally administered amusement taxes.⁵

To ease the task of compliance, states could require jurisdictions levying a locally administered sales tax to provide certain information about the tax to a single entity (e.g., the state tax administration agency) on a regular basis. Making available the rate at which the tax is imposed, information on the tax base and administrative procedures governing the tax, and the ordinances and regulations governing imposition and administration of the tax, as well as contact information for the local entity that administers the tax should be helpful to taxpayers attempting to comply. In particular, information regarding where the local tax base and administrative procedures differ from any counterpart state provisions or deviate from state-provided guidelines would be beneficial. For maximum utility, such information should be available electronically and be updated on an “as needed” basis, but at least annually.⁶

Implementation of this approach is not likely to reduce the taxpayer compliance costs measured for this report significantly by itself. It should, however, improve the ability of taxpayers to comply with locally administered sales taxes by easing the task of identifying which jurisdictions impose the tax and otherwise locating the information necessary to comply.

⁵ See Tables 7, 9 and 11 in Part I (pages 41, 44 and 46, respectively) for an identification of the states for which we were unable to locate central information sources for lodging, food and beverage, and amusement taxes, respectively.

⁶ The information outlined here is generally more detailed than we found and has applicability beyond those states in which we were unable to locate a central source of information. It also has applicability to states with locally administered general sales taxes, especially with respect to areas in which the local tax base and procedures differ from the state, as well as to other locally administered taxes not considered here such as those imposed on business entities, utility taxes and the like.

Conformity with State Tax Base and Procedures

As discussed throughout the report, differences between locally administered sales tax bases and administrative procedures, on the one hand, and those in the counterpart state tax, on the other, as well as differences among local taxes within a single state, add complexity and cost to the compliance process for taxpayers. Such differences often require taxpayers to establish separate processes to identify the different local provisions, monitor changes in them, and ultimately incorporate the differences into their compliance systems. The survey of taxpayers conducted for this report indicates that approximately 25 percent of the total time spent in complying with locally administered general sales taxes is devoted to monitoring changes in tax laws and regulations, training employees on the changes, and incorporating those changes into software and point-of-sale systems used for sales tax compliance.⁷ Based on the survey, we estimate that the total labor cost involved in complying with local sales taxes administered by the state as well as self-administered sales taxes in Alaska, Arizona, Colorado and Louisiana (states in which taxpayers are required to manage differences between state and local tax bases and procedures)⁸ is approximately \$180 million,⁹ meaning that about \$45 million is expended on simply monitoring changes, training employees, and maintaining point-of-sale and tax engine software. Not all of this amount is attributable to differences in tax base and procedures; some is also attributable to managing changes in tax rates. In addition, we estimate that taxpayers in these four states incurred roughly \$120 million in costs for software and programming services for local taxes administered by the state and locally administered taxes, some portion of which is also attributable to managing differences in tax base and procedures between local sales taxes and the state sales tax.¹⁰ Again, a portion of these software and programming costs is attributable to managing varying local tax rates and changes therein.

⁷ See Part II, Table 31. This ratio of time spent varies little among states or as to whether the local tax is administered by the state or self-administered.

⁸ In Alabama, local sales taxes, regardless of whether they are administered by the state or self-administered, must conform to the state tax base and procedures.

⁹ See Part II, Table F.3.

¹⁰ Calculation based on software acquisition and development costs comprising 61.9 percent of non-labor costs for state-administered and locally administered tax compliance in all states (Part II, Table 32). Total non-labor costs for compliance with state-administered and locally administered taxes in Alaska, Arizona, Colorado and Louisiana total \$195 million (Part II, Table F.3).

Some portion of these compliance costs could be eliminated if states required that all local sales taxes, including those that are self-administered by individual localities and those administered by the state tax administration agency on behalf of localities, conform to the counterpart state sales tax with respect to both the tax base and the administrative procedures governing the tax.¹¹ This would not require a change in the filing of returns for local taxes or a change in audit responsibilities, i.e., those responsibilities could still be managed by local governments. Still, it would eliminate the need to separately monitor these items for each local jurisdiction and incorporate the deviations into the compliance processes of taxpayers. This is, in fact, the requirement for locally administered sales, use, rental and lodging taxes in Alabama – where over 400 local jurisdictions self-administer one or more of these taxes.

There are also options short of full conformity between state and local tax bases and procedures that could reduce taxpayer compliance costs, but by a lesser amount than would be the case with full conformity. These options include:

- States could choose to require conformity to the state tax base or the state administrative procedures instead of both or to require less than absolute conformity with respect to either the tax base or the administrative procedures. The cost savings from less than complete conformity will, of course, be less than achieved with complete conformity. Conforming only to the state tax base is likely to yield greater cost savings than conforming only to administrative procedures because certain administrative procedures (e.g., statutes of limitations, appeals procedures) come into play only in compliance situations and do not affect all taxpayers for all tax periods.
- If states choose not to require full conformity with the state tax base, some cost reductions and compliance improvements could nevertheless be accomplished by limiting the deviations from the state base that local governments are allowed to adopt. That is, while locally administered taxes would not be required to conform in all regards to the state tax base, the areas in which localities could deviate from the state would be limited to some relatively small number of identified items. The ability to realize the benefits of this

¹¹ In this context, “administrative procedures” includes, for example, matters such as the statute of limitations for making assessments or claiming refunds, filing frequencies, filing dates, and time periods allowed for responding to notices and assessments.

approach would be enhanced if there is a centrally available, regularly updated registry of the areas in which locally administered jurisdictions choose to deviate from the state tax. Arizona and Louisiana have attempted to accomplish this through the Model City Tax Code (Arizona) and the Uniform Local Sales Tax Code (Louisiana), although there is no central registry regarding local deviations from the state tax base in Louisiana.¹²

Greater uniformity and consistency among local taxes can be achieved even if the state does not impose a state tax that is similar to the locally administered tax (e.g., Alaska sales and lodging taxes, California lodging tax, and Illinois amusement tax). In these cases, the general parameters of the local tax, such as which jurisdictions may levy the tax, general nature of the tax base, and administrative procedures, are set in state law. Greater uniformity could be accomplished by specifying more details in state law. States in this situation could also promote conformity by requiring the use of general state administrative procedures or establishing a uniform set of procedures for locally administered taxes. Requiring greater uniformity among local governments should reduce costs of complying with locally administered sales taxes by reducing the variety of factors that taxpayers need to monitor and incorporate into compliance processes.

The policy choice or trade-off facing state and local governments in considering changes of this sort is whether any policy or administrative benefits that flow from according local governments the flexibility to determine their tax base and administrative procedures outweigh any negative policy impacts of such flexibility and the increased compliance costs incurred by taxpayers because of deviations from the state tax base and procedures. Generally, the argument for local administration of sales taxes revolves around such issues as the ability to provide more individual or localized service to taxpayers and achieving greater audit coverage than can be offered by the state tax administration agency if it is responsible for administering the tax. In the survey of tax jurisdictions conducted for this project, roughly 90 percent of the respondents either agreed or strongly agreed with statements setting forth these propositions.¹³ Issues of localized service and greater audit coverage would not necessarily be diminished in this option because local governments would still be in charge of the administration of the taxes (e.g., receiving returns and

¹² In these two states, the degree of flexibility allowed to local governments is considerable with Arizona allowing 60 areas of difference and Louisiana nearly 180 deviations. *See* discussion in Part I.

¹³ *See* Part II, Table 17.

enforcing the tax). In other words, requiring conformity between state and local tax bases and procedures would not seem to prevent a local tax administration agency from providing the level of taxpayer service and audit coverage it desires.

Also relevant to the discussion is the view sometimes expressed by local officials that the ability to determine the local government tax base enables them to shape the tax base to the economy of the jurisdiction. In the states examined in this project, the ability to deviate from the state tax base has generally been used to adopt a broader sales tax base than is in place at the state level. For example, most of the differences between state and local tax bases in Arizona involve the addition to the local tax base of certain real estate and construction activities as well as food for home consumption. Colorado home rule cities and Louisiana parishes often impose tax on certain manufacturing machinery and equipment and food for home consumption that are not taxable at the state level.¹⁴ In other words, the local governments examined for this report have not, as a general matter, tailored their tax base to any particular set of economic characteristics; instead, they have designed a substantially broader tax base that includes certain business inputs (e.g., manufacturing machinery and equipment) or items that are exempted at the state level (e.g., food for home consumption).

The primary argument made against allowing local sales tax bases to differ from the state tax base relates to the complexity such differences create for taxpayers and the additional compliance costs such differences impose on taxpayers, particularly multistate taxpayers. As detailed in this report, the degree of deviation allowed between the state and local tax bases in the states reviewed here is substantial with the Arizona MCTC providing over 60 options for both program and non-program cities to differ from the state tax base, and local governments in Louisiana being allowed to deviate from the state tax base in nearly 180 areas.¹⁵ In Colorado, where home-rule jurisdictions are accorded substantially unfettered flexibility in determining their tax base and statutory cities have the option of choosing whether to opt-in to 11 different exemptions in the state tax base, the end result is a tax base that is substantially broader than the state base.¹⁶

¹⁴ See discussions of Arizona, Colorado and Louisiana in Part I.

¹⁵ *Id.*

¹⁶ Colorado Dep't of Revenue, *Uniform Sales and Use Tax Base Throughout the State* (2013), available at <https://www.colorado.gov/pacific/sites/default/files/Uniform%20Sales%20and%20Use%20Tax%20Base.pdf>.

The complexities that result from differences in sales tax bases between the state sales tax and local sales taxes within an individual state, as well as differences in sales tax bases among all states, have long been identified as a concern by those studying state and local sales tax systems. It has been a particular concern for groups that have examined the conditions under which states should be authorized to impose a sales and use tax collection obligation on entities that are not obligated under current law to collect tax on sales into a state or locality.

- The Special Subcommittee on Interstate Commerce (commonly known as the Willis Committee) in a 1965 report to Congress recommended that states be allowed to require sellers to collect tax on all sales into a state if the state was part of a group of states choosing to participate in a “cooperative tax administration system” that called for, among other things, a uniform tax base across all participating states with the exception that states could continue to choose whether to exempt food for home consumption and prescription drugs.¹⁷
- As noted above, the Streamlined Sales and Use Tax Agreement, the results of a cooperative government-business effort to identify means of simplifying compliance with state and local sales and use taxes, requires that the tax base for local jurisdictions be identical to the state tax base with few exceptions for a state to be a member of the Agreement.¹⁸ The provisions of the Agreement have been incorporated into the sales tax laws of 23 states.¹⁹
- Recent iterations of proposed federal legislation that would authorize states, under certain conditions, to require remote sellers to collect sales and use tax on sales into the state generally require either that a state be a member of the Streamlined Sales and Use Tax Agreement or that there be no deviations between the state sales tax base and local sales tax bases before a state could exercise the authority granted in the legislation.²⁰

¹⁷ Additional features of the cooperative system recommended by the Willis Committee included administration of the system with respect to interstate sales by the U.S. Treasury Department, a model law among participating states, and an exemption for sellers that were engaged only in pre-paid mail order sales and whose only contact with the state was through advertising. Special Subcommittee on Interstate Commerce, *State Taxation of Interstate Commerce*, H.R. Rep. No. 952, vol. 4, Part VI, 1181–1189 (1965).

¹⁸ Streamlined Sales Tax Governing Board, *Streamlined Sales and Use Tax Agreement*, § 302 (as amended through Sept. 7, 2015). For further discussion, see Part I, pp. 48-51.

¹⁹ *Streamline Sales Tax State Members*, Streamlined Sales Tax Governing Board (last visited Feb. 10, 2016), <http://www.streamlinedsalestax.org/index.php?page=state-info>.

²⁰ See, for example, The Marketplace Fairness Act of 2015, S. 698, (114th Congress) (2015) and The Remote Transaction Parity Act of 2015, H.R. 2775, (114th Congress) (2015). These bills also require certain other

State Administration of Local Taxes²¹

Another option to reduce the costs of complying with and administering locally administered sales taxes that could be considered is to have the state tax administration agency administer local sales taxes on behalf of the local governments, an approach that is currently used in some 30 states that authorize local general sales taxes. In this model, local sales taxes conform substantially to the tax base and administrative procedures of the state tax, and the state tax administration agency is responsible for providing taxpayer guidance, receiving and processing tax returns and payments, and tax enforcement. Local governments are responsible for determining whether to impose the tax and establishing the local sales tax rate (within the parameters of state law). The local tax is an add-on to the state tax, rather than a separate local levy. In these 30 states, tax rates generally vary among local jurisdictions, and taxpayers are required to report the tax due to each local jurisdiction as determined under state sourcing rules on a single return filed with the state tax administration agency.²²

As discussed in Part II of the report, we estimate the incremental cost incurred by taxpayers in complying with self-administered local sales taxes in Alabama, Arizona, Colorado and Louisiana is \$190 million.²³ In this context, the term “incremental cost” means the difference between the costs incurred by taxpayers in complying with locally administered taxes in these four states as compared to the estimated costs of complying with those taxes if they were administered by the state tax administration agency on behalf of the local governments. In the analysis, the estimated

simplifications than identical state and local tax bases (e.g., state-level administration of local taxes) for states that are not members of the Streamlined Sales and Use Tax Agreement to be able to exercise the authority granted in the legislation. The bills also require that the Streamlined Agreement continue to meet certain simplification requirements for its members to be able to require remote sellers to collect, including the requirement for a single state and local sales tax base within a state.

²¹ This option is not applicable to Alaska where the state currently does not impose a state sales and use tax.

²² This is essentially the model embodied in the Streamlined Sales and Use Tax Agreement and the federal legislative proposals identified above that would authorize states to require remote sellers to collect on sales into all states under certain conditions, even if the seller does not have substantial nexus with the state under current law.

²³ See Part II, Table 34. Based on our sampling analysis, we concluded that the results are statistically significant at nearly 80 percent level with a precision of 10 percent on a state-by-state basis. This means we are nearly 80 percent certain that the true population value for any one of these states falls within 10 percent of the values estimated. Further, the cost estimates by type of tax represent meaningful results about variances in costs by type of tax. We applied generally acceptable statistical techniques and arrived at results consistent with prior research findings and studies. As such, we determined the cost estimates by type of tax are reasonable and useful for general understanding about compliance costs. See further discussion in Part II, Section 3.2.

costs of complying with the local taxes if they were administered by the state is based on the actual costs of compliance with state-administered local taxes in Alabama, Arizona and Colorado as reported in the survey.²⁴ The \$190 million figure likely understates the potential savings to taxpayers that would be achieved if these states also required that the local tax base and administrative procedures conform to the state sales tax base and procedures, as is generally the case in the 30 states in which all local sales taxes are currently administered by the state tax administration agency. As noted above, some indeterminable portion of the estimated \$300 million in labor and software-related costs incurred by taxpayers in complying with local taxes in Arizona, Colorado and Louisiana is attributable to monitoring changes in local tax bases and procedures and incorporating those differences into point-of-sale and tax engine software as well as other compliance processes.

In addition, if the state tax administration agency assumes responsibility for administering local taxes without recovering any costs from the local jurisdictions for state administration of the local taxes, local government costs would be reduced by an estimated \$71 million, based on the analysis in Part II.²⁵ The local government cost savings would be offset to some degree if the state tax administration agency assesses a fee to the localities for administering the tax. We reviewed about ten states in which the state tax administration agency administers local sales taxes on behalf of local governments to determine the range of practices currently employed by state tax administration agencies in this regard. They are presented in the table below.

²⁴ See Part II, discussion accompanying Table 34.

²⁵ See Part II, Table 37. This figure does not include local administration costs estimated for Alaska because there is no state sales tax.

State	Fee assessed for State Administration – Percent of Tax Remitted
Alabama	Lesser of \$6.54 per return or 2%
Arizona	No fee
Colorado	No fee for counties and statutory cities; special districts pay incremental cost
Florida	Up to 3%
Illinois	No fee
Kansas	No fee
North Carolina	Fee set to cover state costs; varies monthly
Oklahoma	Up to 0.5%
Tennessee	1.125%
Washington State	Up to 2%; currently 1%
West Virginia	Up to 1%
Source: KPMG telephone conversations with officials in each state.	

Some states (e.g., Arizona, Illinois, Kansas and New York) assess no fee for state administration. In others, the fee ranges from 0.5 percent in Oklahoma to a 3 percent maximum in Florida. If a fee is assessed, it is generally in the 1 percent range.²⁶ Of the states involved in this analysis, Alabama assesses a fee equal to the lesser of \$6.54 per return or two percent of the revenues collected to local governments for administering a local sales, use or rental tax. Colorado assesses a fee equal to the net incremental cost incurred by the Department of Revenue in administering sales taxes for special purpose districts only; Colorado assesses no fee for administering the sales tax for statutory cities or counties. Arizona charges no fee to the program cities for administration of the local sales tax.²⁷ We estimate that the total sales tax collected in the self-administering jurisdictions in Alabama, Arizona, Colorado and Louisiana was about \$10 billion in 2014.²⁸ If these states were to assess an average fee equal to 0.75 percent of the tax collected to administer those taxes that are

²⁶ Telephone conversations with various states conducted in January 2016.

²⁷ Telephone conversations with various states conducted in March 2016. In Alabama, no charge is assessed for a return with no liability.

²⁸ See Part II, Table E.6.

currently self-administered, it would be roughly equivalent to the amount we estimate that the self-administered jurisdictions in the four states currently expend on sales tax administration.

An additional factor to consider in assessing this option is the potential for local governments to see an increase in revenues from sales by sellers that have substantial nexus with the state (i.e., sufficient contacts with the state to allow it to impose a sales and use tax collection obligation), but not with individual locally administered jurisdictions into which they make sales by common carrier delivery or other means. Under the current nexus rules in Alabama, Arizona, Colorado and Louisiana,²⁹ sellers must have nexus in an individual local jurisdiction before the local government may require the sellers to collect tax on sales in the jurisdiction. In states in which the state tax administration agency administers local sales taxes as an add-on to the state tax, sellers having nexus with the state generally are required to collect state *and* local tax on all sales into the state (even if the sellers do not have nexus in an individual local jurisdiction). Thus, to the extent that sellers are not voluntarily collecting local tax on sales into locally administered jurisdictions in which they do not have a collection obligation in Alabama, Arizona, Colorado and Louisiana, local governments could see an increase in revenue if the state administers the local taxes as outlined in this option.

Much as with differences between state and local sales tax bases, groups that have addressed local sales taxes from the perspective of whether states should be authorized, under certain conditions, to require sellers without substantial nexus in the state to collect tax on sales into the state have addressed the issue of state versus local administration of local sales and use taxes.

- The Streamlined Sales and Use Tax Agreement requires that all local sales taxes in a member state be administered by a single state level entity – either the state tax administration agency or another entity established by law for the purpose of administering local sales taxes. Sellers would be required to register and file returns and remittances only with the state level entity, which would also be responsible for auditing on behalf of all local governments.³⁰

²⁹ See discussion Part I.

³⁰ Streamlined Sales and Use Tax Agreement § 301.

- Proposed federal legislation that would authorize states, under certain conditions, to require remote sellers to collect sales and use tax on sales into the state also generally requires either that a state be a member of the Streamlined Sales and Use Tax Agreement or that a state, among other things, provide that all state and local sales taxes be administered by a single entity within the state.³¹

Local Rate Simplification

Adoption of the local sales tax administration model used in most states (state administration of local taxes with a single tax base and set of procedures) will not eliminate all compliance costs associated with local sales taxes. In the 30 states with state-administered local taxes, individual local jurisdictions are generally able to determine the rate at which the sales tax is imposed within their borders, and sellers must report to the state on the local tax collected on sales attributable to each jurisdiction. This means that sellers are required to capture sufficient geographic information on each sale to determine the location to which every sale is to be sourced (“sitused”) under state law, identify the combination of county, city and special purpose district tax rates imposed in that location, and report the amount of local tax collected on sales into each jurisdiction on the return filed with the state. As noted earlier, this often requires assistance from third-party service providers and the use of tax automation software.³²

³¹ See, for example, The Marketplace Fairness Act of 2015, S. 698, (114th Congress) (2015) and The Remote Transaction Parity Act of 2015, H.R. 2775, (114th Congress) (2015). These bills also require that the Streamlined Sales and Use Tax Agreement continue to meet certain simplification requirements for its members to be able to require remote sellers to collect, including the requirement for administration of all local taxes by a state level entity.

³² For further explanation, see Part I, pp. 51-53. Indicative of the complex nature of this task, a Colorado legislative audit report found recently that a system maintained by the state Department of Revenue did not assign taxpayers to the proper taxing jurisdiction based on address information supplied by the taxpayer in about 11 percent of the cases reviewed, in part because of the lack of a computerized geographic information system. There are 279 separate taxing jurisdictions in Colorado. See Colorado Office of the State Auditor, Department of Revenue Local Sales Taxes, *Performance Audit*, p. 21 (2015). In addition, one firm that provides tax automation software recently reported that there were over 600 local sales tax rates changes among all states in 2015. Over the past 10 years, there have been an average of over 200 new local sales taxes adopted annually and over 400 local rate changes annually. See “Vertex Annual Sales Tax Rate Report Reveals 612 Sales Tax Rate Changes in 2014, Up from 492 in 2014,” January 27, 2016 available at <https://www.vertexinc.com/news/vertex-annual-sales-tax-rate-report-reveals-612-sales-tax-rate-changes-2015-492-2014> (last visited March 9, 2016).

The costs associated with this particular aspect of local sales tax compliance could be reduced if states adopted measures to simplify the local sales tax rate structure and sourcing requirements. There are at least two approaches that could be taken.

- States that currently authorize local taxes could replace the local taxes with a single statewide tax levied at a uniform rate throughout the state and not require sourcing to any jurisdiction below the state level.³³ To offset the reduction in local government revenues, states could adopt a program in which state sales tax (or other) revenues are shared with local governments on the basis of a formula determined by the legislature to reflect local government needs or other criteria.
- Rather than adopting a single statewide tax rate and reporting regime, states could establish a mechanism for setting a single local tax rate for each county in the state (parish in Louisiana) and then providing a formula or mechanism for the tax revenues to be shared among local jurisdictions within the county or parish. This would substantially reduce the number of separate jurisdictions and tax rates that need to be considered and tie the rate to a political boundary that is not likely to change, both of which should reduce compliance costs.

Our analysis indicates that adoption of a sales tax regime that includes only a single statewide rate and no requirement to source transactions to individual local jurisdictions or to report tax collected by jurisdiction would reduce taxpayer compliance costs by an estimated \$556 million in Alabama, Arizona, Colorado and Louisiana (i.e., the sum of the estimated total costs for both self-administered local taxes and state-administered local taxes in these jurisdictions). This amounts to just over 70 percent of the estimated costs of taxpayer compliance for all state and local sales taxes in these jurisdictions.³⁴ In addition, local governments would incur no administrative costs, which currently total about \$70 million in these states, under this option.³⁵

³³ This is currently the approach for general sales and use taxes in Connecticut, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, Rhode Island and West Virginia.

³⁴ See Part II, Table 40. The data gathered do not allow us to estimate the potential savings to taxpayers if a county-level tax rate and reporting is adopted. They would be less than adopting a single statewide tax and reporting regime.

³⁵ There would be no state costs to offset these local government savings because there is no local tax being administered. Instead, it is a single statewide tax with no tracking sales to or reporting tax collected to local jurisdictions.

Adoption of either of these options would simplify matters for taxpayers significantly by eliminating or reducing the complexity of sourcing individual transactions to particular local jurisdictions, identifying and applying the applicable rate, and reporting collections by jurisdiction on the tax return. However, each option may also be characterized as running counter to some of the objectives that are commonly identified to support the use of local sales taxes, such as diversifying local revenue sources, reducing reliance on property taxes, and shaping tax structures and bases to reflect the local economy in various jurisdictions. Adoption of a single statewide tax could also involve greater state control over local fiscal resources.³⁶ These concerns could be addressed to some extent if the state adopts a mandatory revenue sharing program that automatically distributes some portion of the sales tax revenue (or other revenue) back to localities through a formula designed to reflect criteria such as population, property tax burden, and other local considerations.³⁷

Eliminating or simplifying the sourcing of transactions to individual local jurisdictions as a means of reducing local sales tax compliance costs has been recommended by various groups, particularly those examining the challenges of local sales tax compliance through the lens of the conditions under which states should be authorized to extend a collection obligation to interstate sellers not required to collect tax on certain sales under current law.

- The Willis Committee referenced earlier would have limited the collection of local sales taxes on interstate sales to those cases in which the local tax was “in all respects statewide” and where no allocation (sourcing) of the sale below the state level was required.³⁸
- The Advisory Commission on Intergovernmental Relations in 1986 recommended adoption of federal legislation that would allow states to require certain mail order sellers to collect tax on sales into the state if the state adopted a single, non-discriminatory state

³⁶ For a more complete discussion, *see* Part I, pp. 11-13.

³⁷ This option may also reduce compliance costs for taxpayers in the 30 states that provide for state administration of local sales taxes by eliminating or reducing the need to separately source transactions to local jurisdictions, identify the appropriate local tax rate, and report the tax collected by jurisdiction to the state. State governments may also experience some administrative cost savings due to the simplification or elimination of the need to account for and disburse local taxes based on collections attributable to individual local jurisdictions.

³⁸ Special Subcommittee on Interstate Commerce, *supra*, at 1187.

and local sales and use tax rate that affected sellers could elect to apply to all sales into the state.³⁹

- The proposal put forth by a majority of the members of the Advisory Commission on Electronic Commerce (ACEC), created by passage of the Internet Tax Freedom Act in 1998, would have required adoption of a single sales and use tax rate for all jurisdictions in a state as part of any system that would extend the jurisdictional reach of states to electronic commerce vendors.⁴⁰
- The National Tax Association Project on Electronic Commerce and Telecommunications, a group with representatives from industry, state governments and local governments that was a precursor to the ACEC that also examined issues of applying current sales taxes to electronic and remote commerce, adopted a three-part consensus position: (a) states with local sales taxes should adopt a single rate for all sales into the state; (b) states should consider some form of revenue sharing to deal with the impact of the single rate on local revenues; and (c) transactions should be sourced only to the state level and not to individual local jurisdictions.⁴¹

In short, there are several avenues states and localities could take to reduce the costs of complying with and administering local sales taxes in general and self-administered taxes in particular. They include: (a) making the information needed by taxpayers to comply with local taxes more readily available; (b) creating greater uniformity between local and state sales taxes while retaining local administration; (c) requiring state administration of local taxes; and (d) simplifying the local tax rate structure. Based on the analysis conducted for this report, the most substantial reductions in taxpayer compliance costs would flow from requiring state administration of local sales taxes and substantially simplifying the local sales tax rate structure in ways that reduce the complexity

³⁹ Advisory Commission on Intergovernmental Relations, *State And Local Taxation Of Out-Of-State Mail Order Sales*, Report A-105, p. 15 (1986), available at <http://www.library.unt.edu/gpo/acir/Reports/policy/a-105.pdf>. The report did specifically address the issue of reporting tax collected on sales into individual local jurisdictions.

⁴⁰ Advisory Commission on Electronic Commerce, *Report to Congress*, p. 19 (2000), available at <http://govinfo.library.unt.edu/ecommerce/report.htm>. The proposal did not specifically address the issue of reporting tax collected on sales into individual local jurisdictions.

⁴¹ National Tax Association, *Communications and Electronic Commerce Tax Project, Final Report*, pp. 13–14 and 28–29 (1999), available at http://govinfo.library.unt.edu/ecommerce/document/final_NTA_Report.doc.

associated with sourcing transactions to individual taxing jurisdictions for purposes of determining the tax rate to be applied and reporting the tax collected.

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In preparing this advice, we considered tax authorities that are subject to change, retroactively, prospectively, or both, and any such changes could affect the conclusions stated herein. This advice is based on the completeness and accuracy of any one or more of the facts, assumptions, and client representations on which we relied, relating to the matters to which this advice is addressed. Unless separately agreed in writing, we will not update our advice for subsequent changes or modifications to the law, regulations, or to the judicial and administrative interpretations thereof, nor to take into account your correcting, updating, or providing new or additional facts or information you supplied or any assumptions on which we relied in preparing our advice.

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