Multistate Tax Commission

Review

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Multitate Tax Commission Review

A Journal on State Taxation of Multijurisdictional Commerce

Published by
Multistate Tax Commission
444 North Capitol Street, NW, Suite 425
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At present, the Review will be issued as a complimentary publication. At some time in the future, the Commission may institute paid subscriptions. The balance of existing subscription payments will be refunded within six to eight weeks.

Please contact Teresa Nelson, Production Editor, with questions concerning new or existing subscriptions, at (202) 624-8699 or mtc@mtc.gov.

Contributions

Submissions by readers of articles, article ideas, suggestions, and criticisms are welcome. Please send them to the editor at the address listed above. We also welcome information concerning changes in employment status of persons active in state taxation in both the public and private sectors.

The opinions expressed in the Review are those of the authors and do not necessarily represent the official position of the Multistate Tax Commission or any of its Member States.

Kentucky Becomes MTC's Third Sovereignty Member

The Multistate Tax Commission is pleased to announce that the Commonwealth of Kentucky has become its third Sovereignty Member State. Sovereignty Membership in the MTC became available to States in 1994 as an opportunity to fully support the activities of the Commission even though a State has not enacted the Multistate Tax Compact. In a November 16, 2000, resolution accepting and welcoming Kentucky as a Sovereignty Member, the MTC Executive Committee expressed its "appreciation to Mike Haydon [Secretary of the Kentucky Revenue Cabinet] for his commitment to developing and strengthening the relationship between the Commonwealth of Kentucky and the Multistate Tax Commission and his pledge to promote uniformity, fairness and simplicity in multistate and multinational taxation."

Kentucky also participates in the MTC's Joint Audit and National Nexus Programs.

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HISTORY AND PURPOSES

States created the Multistate Tax Commission in 1967 to preserve federalism and promote tax fairness. States control and guide the Commission as the administrative agency of the Multistate Tax Compact—an interstate compact upheld by the U.S. Supreme Court in the 1978 *U.S. Steel* decision.

The authority of States to determine their tax policies is at the very core of State sovereignty, but in the fields of interstate and international commerce that authority is subject to restraint by Congress and the U.S. Supreme Court. In the 1960's—prompted by interstate business complaints that disparate State tax policies created unreasonable burdens for interstate commerce—Congress threatened to assume power over State corporate income, gross receipts and sales and use taxation. Faced with this challenge to federalism, States developed the Multistate Tax Compact to promote greater uniformity, efficiency and equity in the taxation of interstate commerce. *The Compact and the Commission it established were a success at their very creation, because they forestalled the proposals for broad federal intervention into State taxation.* The formula of States working together to resolve issues of multistate taxation continues to reduce the degree of federal intervention in the details of State and local tax policy.

The process of States working together through the Commission not only preserves State sovereignty, but also serves to achieve tax fairness. States typically seek to ensure, in the interest of equal taxation, that out-of-state businesses are held to the same standards of tax accountability as local, in-state businesses. However, national and global businesses fear they will be subject to duplicate taxation if different States apply separate and widely different tax rules to interstate commerce. Thus, the Commission assists States in developing and using uniform and effective standards of accountability for national and global businesses so that those businesses will pay their fair share, but not more than their fair share, of a State's taxes. These efforts serve the even larger purpose of supporting a free market economy by helping ensure fair and equal competition among enterprises regardless of type, size or location.

The Commission works to achieve the goals of preserving federalism and tax fairness through a comprehensive range of activities that includes developing recommended uniform state tax policies with respect to interstate commerce, encouraging compliance with tax laws and consistency in enforcement through the Joint Audit and National Nexus Programs, training and education in complex multistate tax issues, supporting States engaged in major and "cutting edge" tax litigation through *amicus* briefs and technical assistance, and advocacy of state interests in the field of multistate taxation to Congress and the Executive Branch.

The Commission is a unique entity to help reconcile and ease the tension between Constitutional provisions that, on the one hand, protect State sovereignty and, on the other hand, restrain that sovereignty with regard to interstate and foreign commerce. By assisting States in working together in taxing national and global commerce, the Commission helps preserve state authority in a manner that also ensures fairness and supports our market economy.

Testimony of
Elizabeth Harchenko
Director, Oregon Department of Revenue

and
Chair, Multistate Tax Commission

On the Issue of Simplification of Sales and Use Tax Law and Taxation of Remote Commerce

Before the
United States Senate
Committee on Commerce, Science, and Transportation
The Honorable John McCain, Chairman

March 14, 2001

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Mr. Chairman and Members of the Committee, I am Elizabeth Harchenko, director of the Oregon Department of Revenue and Chair of the Multistate Tax Commission. It is an honor to appear before this committee. The Multistate Tax Commission is an interstate compact agency with 45 participating states, including the District of Columbia. The Commission works to preserve federalism and to promote fairness, uniformity, and simplification in state and local tax systems.

Thank you for this opportunity to address the most important issue of federalism facing our nation today. That issue is whether Congress will join in partnership with the states to support their efforts to ensure that all commerce, from local to global, is treated in an equal, uniform, and non-discriminatory manner by state and local tax systems. A federal/state partnership is essential to support the free flow of commerce and fair competition in the national marketplace. Forging this partnership will influence the speed and extent to which the benefits of modern technology and economic prosperity spread from one state and region to another. Finally, developing this partnership will shape the future of federalism. It will determine whether states and local governments will be able to perform the role and functions that the nation, including Congress, expects them to perform in supporting the national economy, ensuring the quality of life for all citizens, and doing so efficiently and effectively. Why is it so critically important that Congress join the states in such a partnership? Because the principles on which our nation was founded recognized that the states would work cooperatively through our national government, and that the national government has the power and the resources to support and participate in these joint efforts.

All states and local governments tax their own residents and nonresidents who engage in local and interstate business through different mixes of income, business activity, sales and use, excise and other taxes depending upon local circumstances. Regardless of the types of taxes states and local governments choose to levy, those taxes must apply equitably to all forms of commerce. In this regard, we should all understand that it was never the constitutional intent of the Commerce Clause to deprive states of the ability to ask for a "fair share" contribution from interstate business to support governmental services. Tax policy should not play favorites: similar economic activities should be taxed in similar ways to support the free flow of commerce and equal competition. So balance and equity in taxation between local and interstate commerce is economically essential and constitutionally appropriate.

The greatest imbalance in state and local taxation arises in the area of the collection of sales and use taxes. There is no sound tax policy that supports a tax being collected on a shirt or a music recording or a computer sold through a local store, but not collected when the same product is sold by mail order or through the Internet. States recognize that we must do our part to correct this imbalance by simplifying state and local taxes so that the collection of these taxes does not create an undue burden on interstate commerce. Through the Streamlined Sales Tax Project, the states—working side-by-side with business—have developed measures that will radically simplify sales and use taxes and eliminate undue burdens that may be associated with their collection. In light of this development, Congress should join in partnership with the states and act to level the playing field between local and remote commerce by requiring remote sellers, with sales greater than a national threshold amount, to collect sales and use taxes for those states implementing the Streamlined Sales Tax Project recommendations. Doing so will achieve fundamental fairness and non-discrimination in the application of sales and use taxes between local business and interstate commerce.

Within the context of this partnership, Congress also needs to examine technical language in the Internet Tax Freedom Act —should Congress choose to extend that act for any period— that may exacerbate existing inequities in sales and use taxation. In particular, Congress needs to address the potential for some sellers to bundle extensive services with Internet access and thus avoid sales and use taxes, when other sellers will still be required to collect taxes on those services. Congress should address as well ambiguous provisions in the current definition of discriminatory taxes that may, unwittingly, be encouraging new discrimination in the collection of sales and use taxes.

In addition to encouraging a federal/state partnership, we ask Congress to refrain from making any of the current inequities worse. In particular, Congress should not enact new restrictions on the ability of states to tax a fair share of the income of multistate enterprises. The proposals advanced by some business interests would dramatically change current law and would simply create and multiply within the business activity tax realm the same problems that have existed for sales and use taxes. These proposals would allow a select group of companies to avoid their fair share of state and local taxes and to shift that burden to wage-earners, small businesses and traditional manufacturing and natural resource industries—all of which are captive within the taxing state.

Congress should recognize that in an era when companies can make substantial quantities of sales and earn substantial income within a state from outside that state, the concept of "physical activity" as a standard for state taxing authority is inappropriate. Among other problems, this concept discourages the free flow of investment across state boundaries and restricts the spread of economic prosperity from areas of initial investment to all states and regions. If a company is subject to state and local taxes only when it creates jobs and facilities in a state, then many companies will choose not to create additional jobs and invest in additional facilities in other states. Instead, many companies will choose to make sales into and earn income from the states without investing in them. If Congress ties states to physical activity concepts of taxing jurisdiction, Congress will be choosing to freeze investment in some areas and prevent the flow of new technology and economic prosperity in a balanced way across the nation. Congress should recognize that a standard of physical activity for tax nexus is not in the best interest of our nation, and that sound economic policy requires adoption of practical concepts of economic nexus as a standard for the application of state and local taxes.

Finally, let me briefly address how the nation as a whole, its corporate citizens, and its taxpayers benefit from strong state and local governments and a strong federal/state partnership. The nation relies on states and local governments to educate their citizens for a modern economy and society. It relies on states and local governments for civil order and a framework of commercial law that supports orderly commerce. The nation relies on states and local governments to provide the infrastructure over which commerce flows. It relies on states and local governments to adopt policies that ensure the flow of electrical energy across state boundaries so that the new, technology-based economy can flourish. The genius of our system of federalism is that our nation relies on states and local governments to tailor vital services of national benefit to fit local circumstances. If this system of federalism is to continue to serve this nation well in this new century, then Congress and states must form a partnership to ensure that interstate commerce participates on a full and equal basis to help finance the state and local services that benefit the entire nation.

Mr. Chairman, thank you for the opportunity to address the committee. I will be happy to answer any questions that you or the Committee members may wish to pose.•

Multistate Tax Commission

March 6, 2001

The Honorable John McCain
United States Senate
Washington, DC 20510

The Honorable Ernest Hollings
United States Senate
Washington, DC 20510

Dear Senators McCain and Hollings:

Thank you for your letter of February 26, 2001, in which you request input from the Multistate Tax Commission (MTC) on issues related to the potential extension of the Internet Tax Freedom Act. The Multistate Tax Commission appreciates the opportunity to provide you with its position on issues of state and local taxation of interstate commerce raised in your letter. These views are based on a fundamental commitment to achieving equitable, uniform and non-discriminatory taxation and to securing the benefits of federalism that arise from preserving the proper authority of the states within our nation.

Tax neutrality is essential to achieving equity, uniformity and non-discrimination. Tax policy should not play favorites: similar economic activities should be taxed in similar ways to support the free flow of commerce and equal competition in the national marketplace. States within our nation should be treated in an equal and even-handed manner in support of the economic health, fiscal stability and governmental authority of all. The national economy and the free flow of commerce benefit from the services and laws provided by state and local governments and the efficient tailoring of those services to fit local circumstances. That is the genius of our federal system: by preserving state sovereignty, flexible federalism efficiently supports the national economy.

The MTC provides here a summary response to the points raised in your letter. We will supplement this summary within a few days with a white paper discussing these issues in greater detail.

Should Congress allow states to require all remote sellers to collect and remit sales taxes on deliveries into that state provided that states and localities dramatically simplify their sales and use tax systems?

Yes, provided that remote sellers whose sales do not exceed a specified level of *de minimis* national sales (a "sales threshold standard") be exempt from the requirement to collect and remit state sales or use taxes. The recommendations of the Streamlined Sales Tax Project will dramatically simplify sales and use taxes to a degree sufficient to require remote sellers above a sales threshhold to collect those taxes. Congress should level the playing field between local and remote sellers to advance tax fairness, increase national economic efficiency and growth, and provide for more balanced economic development among states and communities. Congress should form a partnership between the states and the federal government and require remote sellers to collect sales and use taxes once the specified minimum of states have enacted the simplifications recommended by the Streamlined Sales Tax Project. Finally, in light of newly emerging business operations and technologies, Congress should revisit certain provisions in the "multiple and discriminatory" definitions in the Internet Tax Freedom Act if that act is extended. Those provisions, ironically, may increase tax discrimination against local retailers, instead of eliminating that discrimination.

There is no dispute that sales and use taxes are an indispensable element of state and local government finances. No one seriously disputes that such a tax, to be efficient and effective, is best collected at the retailer level—just as federal and state individual income taxes are most efficiently collected through employer withholding.

The inability of the states to require collection of sales and use taxes on remote sales subjects local retailers to unfair competition from remote sellers. Moreover, this substantial inequity violates the standards of tax neutrality and thereby reduces overall economic efficiency and national growth by diverting the allocation of capital away from its most efficient uses. In practical terms, this inequity is a source of additional pressure on the viability of local businesses in communities across the nation—businesses that the marketplace would treat more kindly if only the rules were fair and even-handed.

The inability of the states to require collection of sales and use taxes on remote sales creates a second inequity. It allows remote sellers to benefit from state and local services without helping to collect the taxes that finance those services. The state and local services that benefit remote sellers and, indeed, the national economy are extensive and include: education, university research, state and local infrastructure, public safety, commercial laws, the state court systems, environmental management and energy conservation and development, among others. A sampling of just some of these benefits includes: states and localities provide the roads used by the contract carrier to deliver goods purchased by remote commerce; states provide the courts that enforce the security interest of the remote seller in an installment sale to ensure proper payment; states finance the schools and universities that educate workers for the high technology industry and provide markets for computers and software . . . and the examples go on. Thus, remote sellers should bear the responsibility of participating in the process of financing these services.

The inability of the states to require collection of sales and use taxes on remote sales leads to yet a third inequity. The failure of a large portion of remote sellers to collect sales and use taxes typically allows their customers to escape paying sales and use taxes they owe. In the case of Internet purchases that require ready access to a properly connected computer, these customers tend to have higher incomes than the general population. The ability of higher income individuals to avoid the sales and use tax on purchases from remote sellers puts pressure on state and local governments to keep the rates of sales taxes artificially high to support needed services. This shifts the tax burden to those with the least ability to pay and increases the regressive nature of the sales tax.

In addition, the failure of remote sellers to collect sales and use taxes confuses the public into believing that tax is not due on remote sales. Accordingly, when states attempt—as they increasingly have in recent years—to collect from purchasers the lawfully due use tax, the state is wrongfully accused of imposing a new tax when, in fact, the state is only seeking to collect a tax that has been on the books for decades. By failing to collect the tax, remote sellers first create a collection problem for the states and then make it more difficult for states to solve that problem.

Finally, the current judicial interpretation of nexus for use tax—so-called “physical presence nexus”—actually prevents the free flow of interstate commerce and detracts from balanced economic development by acting as a barrier to capital investment flowing from one state into another. Companies have a disincentive to create jobs and invest in facilities in different states because once they establish facilities in the state they will be subject to a sales and use tax collection requirement. The ability of companies to make substantial sales into a state, but not collect that state’s sales and use taxes, distorts investment decisions. This circumstance tends to “freeze” economic development in states where certain activities originate and prevents the flow of investment into other states in a balanced manner. Thus, the current state of case law, absent congressional action, unwittingly favors some states and regions and prevents investment and prosperity from flowing evenly to all areas of the nation.

Congress can remedy this state of affairs by adopting—consistent with the nature of the modern economy and the principle of tax neutrality—a practical sales threshold standard requiring remote sellers with sufficient sales to collect sales and use taxes. Companies exceeding the sales threshold would no longer refrain from investing in a state out of a fear the investment would trigger a new collection requirement. Instead, the investment would be evaluated entirely on its free market merits. Moving to a sales threshhold standard for sales and use tax collection for remote commerce will eliminate a barrier to the free flow of investment across state boundaries and help generate more balanced economic development across the nation.

In summary, the states' inability to require the collection of sales and use taxes on remote sales constitutes bad tax policy, is inequitable and causes real economic damage. It is unfair to ask local retailers to compete with remote sellers who do not collect tax on identical sales, and that unfair competition creates economic pressures on local businesses and the communities that rely on them. It is unfair for remote sellers to escape collecting the taxes that finance state and local services from which they benefit, and that failure impairs the proper financing of those services. It is unfair that higher income taxpayers can disproportionately avoid sales and use taxes, and that shift in the tax burden makes it harder for lower income families to make ends meet. It is unfair that current standards of sales and use tax nexus tend to freeze economic development in the places of initial investment and prevent prosperity from flowing evenly to all states and regions of the nation. Congress as a matter of equity and sound economic policy should require remote sellers with sales above a certain threshhold to collect sales and use taxes in conjunction with state efforts to streamline the administration of those taxes.

States recognize that the current sales and use taxes need to be updated to fit with the modern economy. Forty states—thirty-two voting states and eight observers—have undertaken the Streamlined Sales Tax Project with the active involvement of the multistate business community. The project's work is described in greater detail below. At this point it is sufficient to note that the project has identified the critical areas of change needed to make existing sales and use taxes work efficiently in the modern national economy. Congress should enact a "sales threshhold" remote sales collection requirement—subject only to a subsequent congressional veto—when a sufficient number of states have adopted an interstate compact implementing simplification in the areas identified by the Streamlined Sales Tax Project. The federal-state partnership approach will achieve a level playing field in sales and use tax collection based on dramatic simplification of those taxes. Such a role for Congress was clearly envisioned by the framers of our Constitution. If Congress is not prepared to enter into this partnership with the states, it should refrain from specifying the details of simplification and should not preempt the sovereign right of states to have full and fair access to the courts to secure judicial approval of simplifications they may enact.

One final point. The combination of two obscure, ambiguous provisions in the definition of "discriminatory taxes" in the Internet Tax Freedom Act [Section 1104 (A)(iii) and (B)(ii)(II)] may be inadvertently encouraging new inequities among retailers. Some retailers are placing Internet kiosks in local stores, making sales through those kiosks and allowing customers to return goods to those local stores. A portion of these retailers collect sales and use taxes on their Internet sales. Other retailers employing this practice do not. States find no legal justification for the retailers that fail to collect the sales taxes, despite their physical presence, other than the possibility of an ill-advised reading of the two provisions cited above whose language is manifestly unclear. While states would dispute this unfortunate reading of these provisions, their ambiguity should not be creating new discrimination in the marketplace. They should simply be eliminated if Congress chooses to extend the Internet Tax Freedom Act.

Should goods purchased from remote sellers be taxed at the same rate as goods purchased through more traditional means (e.g., in-store sales)?

Yes, it is sound tax policy for the same goods to be taxed at the same rate within any given jurisdiction. Further, the U.S. Constitution requires that goods sold by remote means be taxed at a rate no higher than goods sold locally, and many state constitutions effectively require goods sold by different means to be taxed equally. Applying the same rate to different modes of selling fulfills the fundamental economic precept that taxes should operate neutrally. Otherwise a tax system in effect chooses winners and losers and displaces the free market determination of efficient and viable economic activity. Once the law selects economic favorites, the interests that benefit from the favored treatment work to preserve their privileged status to the detriment of non-favored players without regard to any underlying need for such protection. Taxing the same good at different rates based on delivery would perpetuate all of the inequities and problems associated with the present circumstance where many remote sales are taxed at a zero rate while local sales of the same goods are taxed at a full rate.

Furthermore, the U.S. Constitution requires that tax rates on products sold in interstate commerce be no higher than on products sold locally. The states accept this fundamental understanding of non-discrimination that supports the national market in our federal union. Traditional local commerce must bear its fair share of taxation as much as interstate commerce, including electronic commerce. The rule is well established that the tax rate imposed on sales by remote sellers not exceed the rate that is imposed on goods sold through the more traditional means. Thus, no further congressional action is needed to ensure equity in tax rates applied to both local and remote sales.

What simplifications in state and local sales and use tax laws would you consider important to reduce the burden of compliance?

The recommendations of the Streamlined Sales Tax Project will dramatically simplify the sales and use tax and will reduce compliance burdens for multistate businesses sufficiently to support Congress allowing states to require remote sellers exceeding a specified sales threshhold to collect state and local sales taxes. The work of having multistate businesses identify the areas of simplification actually began over six years ago with the industry-led MTC Sales Tax Simplification Committee created by the Multistate Tax Commission. Business representatives on that committee from the American Institute of Certified Public Accountants (AICPA), the Committee on State Taxation (COST), the National Tax Association (NTA), the Tax Executives Institute (TEI) and the Institute for Professionals in Taxation (IPT) completed an inventory of desired areas of simplification in 1997. That process has continued through several other regional and national projects and studies involving multistate businesses, including the National Tax Association Communications and Electronic Commerce Tax Project cited in the Internet Tax Freedom Act. This extensive process of multiple state-industry consultation has reached a sound conclusion in the recommendations of the Streamlined Sales Tax Project. Congress can with confidence endorse—as a complete, comprehensive and sufficient package—the areas of simplification addressed by the project in legislation authorizing states to require collection of sales and use taxes by remote sellers.

Perhaps the most significant area in which simplification is required—and is being addressed effectively by the Streamlined Sales Tax Project—is in reducing the number of sales and use tax returns and reducing the number of tax bases in each state and all of its local entities. Using the benefits of statewide administration, the number of returns a retailer is required to file can be reduced from hundreds nationwide to one per state. Concurrently, the number of tax bases should be reduced so that retailers will be required to keep track of one tax base per period for each state into which it makes sales. These changes radically reduce the compliance burden of multistate retailers. A few dozen returns will suffice for even the largest retailers where hundreds of returns were required before. Smaller retailers will see comparable reductions.

The other areas of simplification being addressed by the Streamlined Project include:

- a centralized, one-stop, multistate registration system for participating sellers;
- uniform definitions for goods or services;
- uniform rules for attributing transactions to particular taxing jurisdictions;

- uniform procedures for handling sales that are exempt from sales and use taxes by virtue of the nature of the purchaser or the use of the purchased item and relief from liability to the states for sellers that rely on such state procedures;
- uniform procedures for certifying software that sellers may elect to determine applicable taxes and relief from liability to the state for sellers that rely on such software;
- simplified, uniform procedures for claiming bad debts;
- a uniform format for tax returns and remittances; consistent electronic filing and remittance methods;
- uniform audit procedures;
- appropriate protections for consumer privacy;
- limitations on the frequency with which local units of government may change their sales and use tax rate and the provision of adequate notice to sellers of the effective dates of such changes;
- standardized procedures requiring each state to provide sellers with the information necessary to assign the appropriate sales and use tax rate to any transaction attributed to the state and relief from liability to the states for sellers relying on such information provided by a state;
- and a study of the cost of collection by retailers before and after simplification.

In total, the elements addressed by the Streamlined Sales Tax Project are the areas of simplification most important to reducing burdens of compliance with sales and use taxes.

Does simplification necessarily mean that states will have to develop one tax rate per state to apply to a certain taxable good?

No. All of the simplification benefits of one rate per state can be achieved largely through the approach developed by the Streamlined Sales Tax Project. That approach combines uniform, strategic simplifications in tax policy with technology. Those simplifications include: a) limiting rate changes to quarterly periods, b) providing uniform advance public notice of the changes, and c) relieving enterprises of liability for errors in local rates if they use databases of local rates provided by states. Congress, in the Mobile Telecommunications Sourcing Act, PUB. L. 106-252, 114 STAT. 626 (2000), has already endorsed the use of governmentally supplied tax rate databases. The advantage of the Streamlined Sales Tax Project approach is that it achieves efficiency and simplification for interstate commerce, while allowing states and localities to tailor fiscal policy to fit local needs. It avoids, in particular, the problem of raising taxes in rural areas to finance services in urban areas that is inherent in requiring “one rate per state.”

The latter portion of the question appears to raise the question whether Congress should require states to eliminate different state tax rates for different goods, such as lower rates on food or electricity than on other items. The states in the Streamlined Sales Tax Project chose wisely to develop a proposal for the phase-out of most of the differential state tax rates that apply to different items of personal property or services. Although current computer technology is sufficiently advanced to be able to assign different rates to different taxable items accurately, having one state rate for most taxable goods certainly is more easily administered. However, the states recognized that a simplified sales tax system could accommodate multiple rates for high value, durable goods such as motor vehicles, aircraft, watercraft, modular homes, manufactured homes and mobile homes—goods that are typically subject to either registration requirements or property taxation. Accordingly, the states did not adopt a phase-out for multiple rates on these enumerated items.

Should Congress reconsider the definition of Internet access, and if so, how would you propose defining Internet access?

If Congress extends the moratorium on state and local taxes on Internet access, it should re-evaluate the definition of Internet access within the moratorium to account for the increasing variety and extent of services that are “bundled” with access.

Since Congress wrote the original definition, changes in technology and corporate business structures have made it clear that it is now possible for large enterprises to bundle a broad array of otherwise taxable services with Internet access. The current definition appears to create the potential for discrimination in tax policy that would stifle competition and increase consumer costs, provide financial advantages to large enterprises, and erode state and local tax bases. Services delivered by large enterprises that can assemble the capital, technological, information and entertainment resources to bundle an array of services with Internet access would appear to be granted a tax exemption under the current language of the moratorium. The same services delivered through the Internet by smaller enterprises without the bundling capability or by non-electronic means would remain taxable. There is no economic or tax policy justification for Congress to create this disparity. Expanded bundling by large enterprises can substantially erode the tax bases of state and local governments that tax services.

The definition of Internet access should cover only access to the Internet. Because of the increasing problems in distinguishing between pure access and other services, Congress should explore a quantitative approach to defining access, such as was enacted by the State of Texas in the last few years.

The Commission has a neutral position on the question of whether or not Congress should extend a moratorium on state and local taxes of the Internet. We oppose removing, however, the "grandfather protection" in the Internet Tax Freedom Act for state and local governments levying taxes prior to the original moratorium as an unacceptable preemption of existing state and local tax policy.

Again, this list is not exhaustive. We welcome any and all comments. Our expectation is that the Commerce Committee will conduct a hearing on the Internet tax issue soon after we receive your policy recommendations.

The questions you raise in the letter of February 26, 2001, reflect a proper focus by the Senate Commerce Committee on sales and use taxes. The U.S. Supreme Court in its *Quill* decision invited Congress to address the issue of use tax collection by remote sellers. We are aware that some interests have sought to burden the sales and use tax issue with unrelated topics, especially the question of the authority of states to levy business activity taxes. Action by Congress to extend the authority of states to require the equitable collection of sales and use taxes will not result in a change in the authority of state and local governments to levy business activity taxes. Claims to the contrary are simply false.

The proposals advocated by some with regard to business activity taxes would dramatically change existing law. Typically the proposals would impose new restrictions on state authority in the form of physical activity standards of nexus for business activity taxes (including corporate income taxes, gross income or gross receipts taxes, and capital stock and franchise taxes). The imposition of these new standards would simply create and multiply within the business activity tax realm many of the problems that have existed in the context of sales and use taxes. Again, tax equity would suffer. Companies earning income from within a state and benefiting from state and local services would be excused from paying their fair share of the cost of those services. These proposals would elevate corporate form over economic substance and allow companies, through sophisticated tax strategies, to shift income unfairly away from where it was earned to tax haven locations. In terms of tax equity, the net result of the proposals would be to allow a select group of corporations to escape their fair share of state and local taxes and to shift that burden to wage-earners, small businesses and traditional manufacturing and natural resource industries—all of which are "captive" within the taxing state.

These proposals for new restrictions on state authority to levy business activity taxes would also detract from economic efficiency and balanced economic development by, again, discouraging the flow of investment across state boundaries. The physical activity approach to state authority is really an anachronism arising out of 17th and 18th century mercantilism. Centuries ago, the only way enterprises could earn income from a territory would be to undertake physical activities there. Today, companies can earn substantial income from a state—and in the process benefit from the services of a state—with only minimal activities that might traditionally be labeled “physical.” To achieve tax neutrality—taxing the same income earned in the same state to the same degree—concepts of physical activity as a standard for state taxing authority need to be assigned to the dustbin of history. If companies can earn income from within a state, but escape taxation by keeping their activities within the boundaries of certain physical activities defined in a new federal law, then companies will be discouraged from going beyond those physical activities and making new and more substantial investments in that state. Thus, the proposals for new federal laws restricting state business activity taxes will only interfere with the free flow of commerce and balanced economic growth across the nation.

Thank you again for providing an opportunity for the Multistate Tax Commission to offer information and perspective on this important issue. The MTC would be glad to provide you with any further information or to answer any questions you may have. Please feel free to contact Dan Bucks, MTC Executive Director concerning these issues at 202-624-8699.

Sincerely,

Elizabeth Harchenko

Elizabeth Harchenko
Director, Oregon Department of Revenue
Chair, Multistate Tax Commission

cc: The Honorable Ron Wyden, U.S. Senator
The Honorable Byron Dorgan, U.S. Senator
The Honorable George Voinovich, U.S. Senator
The Honorable Mike Enzi, U.S. Senator
The Honorable John Kerry, U.S. Senator

State Fiscal Issues and Risks at the Start of a New Century

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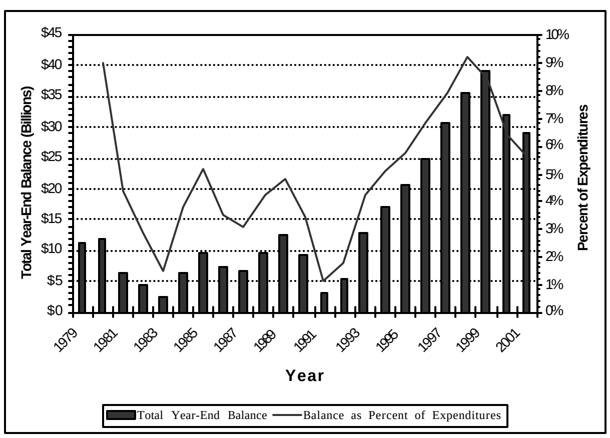
Introduction

States have been flush with revenue during the mid- and late 1990s. The economy has been stronger than expected, financial markets have boomed, and inflation has been benign. Taxes consistently have come in above expectations, spending has fallen below projections, and states have had unbudgeted surpluses year after year. They have responded to this good news by increasing spending significantly, by cutting taxes for six consecutive years, and by increasing reserves to 20-year highs.

As shown in FIGURE 1 below, total state year-end balances have risen from less than $5 billion at the end of fiscal year 1991 to more than $39 billion at the end of fiscal year 1999. Estimated balances at the end of fiscal 2000 are approximately $32 billion. Recommended balances at the end of fiscal 2001 are projected to be $29 billion. The year-end balances have risen faster than state expenditures during the 1990's. Year-end balances at the end of fiscal 1991 were about 1 percent of expenditures; at the end of fiscal year 1998, balances were more than 9 percent of expenditures. Recommended balances at the end of fiscal 2001 are 5.6 percent of expenditures.

Figure 1 State Government Year-End Balances: Total and as a Percent of Expenditures: 1979 to 2001

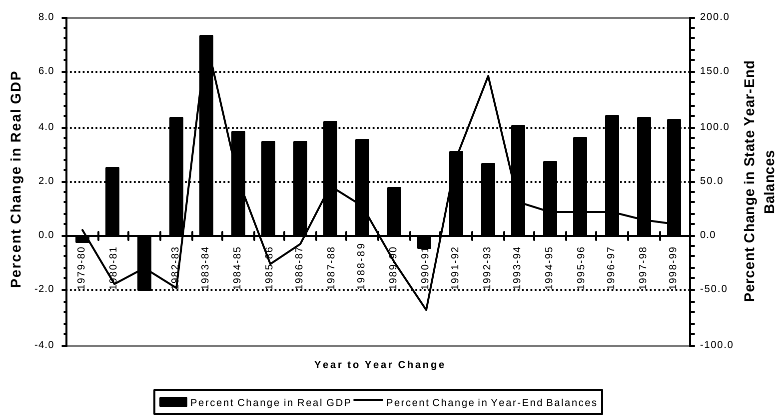


Source: National Association of State Budget Officers.

States' capacity to manage bad news is hard to measure. One of the most common measures that speak partly to states' abilities to manage risk is the size of reserve funds. States build reserves up in good times and draw them down in bad times. As Figure 2 shows: when real gross domestic product growth slows or declines, as in the 1980-82 double-dip recession and as in the 1990-91 recession, reserves fall, and when growth accelerates states rebuild reserves.

At the end of fiscal 1998 state reserve funds, at 9.2 percent of spending, were at a 20-year high.[1] Is this enough to manage the next recession when it arrives, sooner or later? Probably not. First, inspection of the graph in FIGURE 2 shows that states draw down reserves quite rapidly in a recession. In the relatively deep 1980-82 recession, states drew fund balances down from 9 percent in fiscal 1980 to 1.5 percent in fiscal 1983, and in the relatively mild 1990-91 recession states drew reserves down from 4.8 percent in fiscal 1989 to 1.1 percent in fiscal 1991.

Figure 2 Percent Change in 1996 Constant Dollar Gross Domestic Product (GDP) and Percent Change in State Government Year-End Balances: 1979-80 to 1998-99



Source: Bureau of Economic Analysis and National Association of State Budget Officers.

Furthermore, the use of reserves was dwarfed by other actions states took. Over the period from 1981 through 1985, cumulative state tax increases amounted to approximately 27 percent of state spending, dwarfing the 7.5 percent drawdown of reserves. Similarly, cumulative tax increases in the 1989-through-1994 period were 13 percent of state spending, compared with a reserve drawdown of 3.7 percent.[2] In addition, states adopted large spending cuts during the two recessions, although there are no ready measures of aggregate spending cuts.

Is everything as rosy under the surface as it appears? Is the outlook for state finances as attractive as the recent past? What risks are lurking, and what significant longer-term trends are emerging? That is the subject of this article.

Potential Economic Issues and Risks

Entire state revenue structures face risks related to the economy. Despite the economy's recent persistent ability to outperform forecasters' expectations, most economic forecasters continue to predict that the economy will slow from its torrid pace. Economists generally believe that productivity growth, employment, and gross product (the broadest measure of the economy) will slow in the years ahead. TABLE 1 based on estimates and forecasts provided in February 2000 by Regional Financial Associates, a major economic forecasting firm, compares growth in gross state product over the 1995 to 2000 period with projected growth over the 2000 to 2005 period. RFA expects that in 44 of 50 states, economic growth in the next five years will be slower than growth in the previous five years. As a general rule, states that grew fastest between 1995 and 2000 — frequently Southern and Western states — are expected to slow the most, although they would remain fast-growing relative to the rest of the nation.

TABLE 1

Change in Growth of Gross State Product by State: 1990-2000 to 2000-2010

	Gross State Product: 1987 $				Gross State Product: 1987 $		
	Average Annual Change		Change		Average Annual Change		Change
State	1990 - 2000	2000 - 2010	1990-2000 to 2000 - 2010	State	1990 - 2000	2000 - 2010	1990-2000 to 2000 - 2010
California	1.64%	2.15%	0.51%	South Carolina	2.68	2.15	-0.54
District of Columbia	0.69	0.99	0.29	Florida	2.92	2.36	-0.56
Rhode Island	1.33	1.61	0.28	Alabama	2.37	1.80	-0.56
Connecticut	1.48	1.72	0.25	New Hampshire	2.48	1.92	-0.56
Alaska	1.19	1.41	0.22	Minnesota	2.40	1.78	-0.62
Maryland	1.48	1.69	0.21	Texas	2.60	1.94	-0.66
Maine	1.54	1.75	0.21	Nebraska	2.43	1.77	-0.67
New York	1.17	1.27	0.10	Wyoming	2.47	1.78	-0.69
Massachusetts	1.59	1.61	0.02	Wisconsin	2.48	1.78	-0.70
Virginia	1.90	1.87	-0.03	Indiana	2.47	1.73	-0.74
Vermont	1.91	1.86	-0.05	Oregon	2.72	1.98	-0.75
New Jersey	1.69	1.61	-0.08	Arizona	3.23	2.43	-0.80
Louisiana	1.58	1.45	-0.13	Kentucky	2.50	1.68	-0.82
Missouri	1.90	1.70	-0.20	Georgia	3.01	2.18	-0.83
Oklahoma	1.81	1.57	-0.25	Delaware	2.82	1.89	-0.93
Pennsylvania	1.68	1.42	-0.26	North Carolina	2.92	1.99	-0.93
United States	2.11	1.82	-0.29	Mississippi	2.69	1.74	-0.95
Illinois	2.00	1.66	-0.34	Colorado	3.25	2.22	-1.04
Kansas	2.11	1.74	-0.36	Arkansas	2.91	1.80	-1.11
North Dakota	1.92	1.55	-0.37	Montana	3.06	1.92	-1.14
Michigan	1.79	1.41	-0.37	Tennessee	3.10	1.94	-1.16
West Virginia	1.82	1.44	-0.37	South Dakota	3.30	1.98	-1.32
Hawaii	2.23	1.83	-0.40	Utah	3.96	2.63	-1.33
Ohio	1.92	1.52	-0.40	Idaho	3.61	2.16	-1.45
Iowa	1.95	1.54	-0.41	Nevada	4.28	2.67	-1.61
Washington	2.65	2.17	-0.48	New Mexico	3.97	2.15	-1.82

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

The idea of a slowdown is plausible and widely believed, and states certainly would be prudent to anticipate this in their planning. It reflects a return toward historically more-normal productivity growth, and slowing labor force growth. Slowing economic growth almost certainly will mean slowing revenue growth, and could lead to higher spending in some areas well. The projections suggest that Oregon and New Hampshire will face the greatest challenges in managing slowing growth, followed by Iowa, Texas, and Idaho to round out the top five. Of the six states expected to accelerate, only Alaska and Hawaii are expected to accelerate significantly (above 2 percent). Both states were in the doldrums in the 1995-to-2000 period.

In addition to the risk of economic slowing leading to slower revenue growth, states need to be wary of general "wild-card" economic risks. Most of the states that have faced fiscal difficulty in recent years have faced it not because of a general economic malaise, but because their economies were especially susceptible to weakness in one or more sectors. For example, Iowa recently ran into difficulty due to depressed farm prices, and Louisiana and Wyoming ran into difficulty because of low prices for oil and minerals. Each of these sector-specific problems spilled over into the state economy at large because the state economy was highly dependent on the sector. Texas had similar problems during the mid-1980s oil-price collapse, New York and New Jersey suffered during the financial sector meltdown of the early 1990s, and Massachusetts was hurt by the construction and minicomputer collapses of the early 1990s.

Key State Revenue Issues

State revenue structures are extremely sensitive to economic conditions. This section discusses key factors affecting the two largest revenue sources, individual income taxes and general sales taxes as well as the benefits of balance in a state revenue structure.

The Income Tax

The income tax is tied with the sales tax for the largest state tax. On average states rely on income taxes for about 18 percent of their revenue, although this varies considerably, ranging from 30 percent in Massachusetts to nothing at all in the states without an income tax. The income tax is often considered attractive from a revenue-raising perspective because most state income taxes are "elastic" — as income rises from one year to the next, tax revenue rises at an even faster pace. This elasticity is the natural result of the progressive structure of income taxes: effective rates rise as income rises. When taxpayers' incomes rise, whether due to wage inflation or productivity gains, they move into higher tax brackets with higher effective tax rates, so that tax liability rises more rapidly than income.[3]

For people worried about how to finance government services, this tax elasticity is a good thing over the long haul, as it leads to rapid revenue growth, and to increases in tax burden (measured simply) without requiring explicit tax increases. For exactly the same reason, it is unattractive to those who favor low taxes and limited government.

But even for those who appreciate rapid revenue growth, the income tax's elasticity can have a dark side. Progressive tax structures raise disproportionate amounts of revenue from upper- income taxpayers. Nationally, taxpayers with income of $500,000 or more accounted for about 0.3 percent of tax returns, but 23 percent of federal income tax liability. At the state level, these high- income taxpayers would constitute a less skewed portion of tax liability, because state income taxes are less progressive than the federal income tax, but we do not have the data needed to know how much less concentrated state tax liability is.[4] These taxpayers tend to have relatively large concentrations of income that is volatile, both because it is highly sensitive to changes in the economy and because taxpayers have considerable control over when to recognize the income for tax purposes.

For example, for taxpayers with adjusted gross income of $500,000 or more in 1997, wages accounted for only 35 percent of that income, whereas wages accounted for 78 percent of adjusted gross income for taxpayers with income below $500,000. By contrast, capital gains accounted for 33 percent of the income of taxpayers with income of $500,000 or more, versus only 4 percent for taxpayers below $500,000. Partnership and S Corporation income accounted for 19 percent of income for the high-income group versus only 2 percent for taxpayers with income below $500,000.

The economically sensitive nature of nonwage income, especially capital gains; the fact that its timing is partially under taxpayer control; and the relatively higher marginal rates at which it is taxed combine to make income taxes quite volatile in a cyclical sense. Economists Richard Dye and Therese McGuire recently estimated the real cyclical (short-run) elasticity of state income taxes.[5] The median of their state elasticity estimates was 1.18 (i.e., their estimates imply that the typical state income tax grows about 18 percent faster than income). The estimates ranged from a high of 1.68 in California to a low of 0.95 in Indiana, as shown in TABLE 2. The differences in elasticities primarily

Table 2
Cyclical Elasticity of State Taxes

State	Individual Income	General Sales	Combined Income & Sales	State	Individual Income	General Sales	Combined Income & Sales
U.S. Median	1.18	1.07	1.12	Montana	1.29	n/a	1.29
Alabama	1.03	1.07	1.05	Nebraska	1.37	1.10	1.24
Alaska[1]	n/a	n/a	n/a	Nevada	n/a	1.30	1.30
Arizona	1.28	1.05	1.13	New Hampshire	n/a	n/a	n/a
Arkansas	1.32	0.98	1.13	New Jersey	1.34	1.26	1.30
California	1.68	1.30	1.50	New Mexico	1.37	0.98	1.11
Colorado	1.06	1.23	1.12	New York	1.18	1.15	1.17
Connecticut	1.43	1.07	1.26	North Carolina	1.12	1.05	1.09
Delaware	1.09	n/a	1.09	North Dakota	1.34	1.20	1.25
Florida	n/a	1.15	1.15	Ohio	1.22	1.34	1.27
Georgia	1.09	0.85	0.98	Oklahoma	1.07	1.03	1.05
Hawaii	1.12	0.88	0.98	Oregon	1.00	n/a	1.00
Idaho	1.24	1.07	1.16	Pennsylvania	0.95	1.37	1.17
Illinois	0.95	1.02	0.99	Rhode Island	1.34	1.29	1.32
Indiana	0.95	0.96	0.96	South Carolina	1.21	1.05	1.12
Iowa	1.28	0.96	1.13	South Dakota	n/a	0.98	0.98
Kansas	1.19	1.08	1.13	Tennessee	n/a	1.10	1.10
Kentucky	1.02	1.05	1.04	Texas	n/a	1.07	1.07
Louisiana	1.34	1.09	1.20	Utah	1.13	0.98	1.05
Maine	1.18	1.23	1.20	Vermont	1.34	1.27	1.31
Maryland	1.05	1.37	1.16	Virginia	1.08	1.09	1.08
Massachusetts	1.17	1.23	1.19	Washington	n/a	1.13	1.13
Michigan	0.95	1.01	0.98	West Virginia	1.14	0.99	1.07
Minnesota	1.15	1.01	1.09	Wisconsin	1.10	1.25	1.15
Mississippi	1.26	1.05	1.11	Wyoming	n/a	0.93	0.93
Missouri	1.18	1.03	1.11				

1. Local sales taxes only.

Source: Dye and McGuire 1998.

reflect differences in tax structures — California has a steeply progressive rate structure, whereas Indiana's tax is essentially flat. Elasticities also will vary across states depending on differences in income distribution.

A high elasticity implies a more volatile tax during business cycles — one that is more susceptible to rapid growth during an upswing, and potentially rapid declines during downturns.[6]

To the extent that state income taxes have become even more reliant on high-income taxpayers in recent years, this cyclical elasticity, or potential volatility, is likely to increase. TABLE 3 shows the astounding recent growth in the number of high-income taxpayers through 1997 (the latest year for which data are available):

Table 3
Growth in Federal Individual Income Tax Returns Filed by Adjusted Gross Income (AGI)

Year	Number of Federal Income Tax Returns: All	Number of Federal Income Tax Returns: AGI > $500,000
	(Percent Change Over Preceding Year)	
1994	1.20%	5.80%
1995	2.00%	21.10%
1996	1.80%	22.40%
1997	1.70%	25.10%

Source: Internal Revenue Service.

In each of the three latest years, the number of returns with income above $500,000 has grown by more than 20 percent, and far faster than the overall numbers of returns. While it is natural to expect the number of high-income returns to grow more quickly than the number of lower-income returns due to the effects of "bracket creep" (inflation and productivity-driven income growth), the extent of the difference is impressive.

States have seen this income growth reflected in their revenue collections. Revenue estimators in several states have remarked that tax liability in recent years has grown as much as twice as fast as personal income — an elasticity of 2! — and even more in some years. Income tax revenue has far outstripped states' expectations. Furthermore, this rapid growth appears to have continued beyond 1997: although data from tax returns are not yet available, state tax collections in April of 1999, for 1998 tax returns, suggest that 1998 was yet another banner year, and recent tax collections suggest that the 1999 tax year may have been strong as well.[7]

States do not know for sure what has caused this explosive growth in income tax revenue, but most revenue estimators appear to believe that strong stock markets have played a major role, although other factors are at work as well.[8]

Rapid rises in stock prices make it more likely that taxpayers will be sitting on large potential capital gains. Taxpayers need not "realize" their gains by selling stocks, thereby creating tax liability; but all else being equal, higher stock prices tend to lead to more taxable gains. In addition, reductions in federal effective tax rates on capital gains have encouraged taxpayers to "unlock" these gains — that is, realize gains for tax purposes. A rising stock market also benefits the income tax in other ways — many corporations, especially high-tech corporations, have granted their employees stock options that, when exercised, can generate significant tax liabilities. This income may be treated as wages but it is clearly related to the stock market.

While states appreciate the fiscal benefits of a strong stock market, they recognize this good news creates uncertainties and fiscal risks. As California's Legislative Analyst's Office recently put it:

. . . the rise in stock market values has made the state's revenue stream much less predictable from year to year than in the past. This is because capital gains are inherently far more volatile than, for example, wages or taxable sales. Although capital gains account for only 20 percent of PIT receipts and about 10 percent of total General Fund revenues, their greater volatility can produce as large, if not larger, a revenue drop-off than other taxes typically experience during times of economic slowdown or recession. For example, capital gains historically have fallen by as much as 50 percent in one year, which would translate into a potential reduction of as much as 10 percent in PIT revenues and 5 percent in total revenues.[9]

Just how much risk is there for states, and which states are at greatest risk? State income taxes are far more volatile than a simple interpretation of the cyclical elasticity estimates we looked at earlier might suggest, and these estimates might lull states into a false sense of complacency. Depending on the different rates at which various kinds of income grow, in any given year state income tax revenue can swing far more wildly than point estimates of cyclical elasticity might suggest.

The following is an illustrative example of how severe the slowdown in tax liability growth could be under a baseline scenario in which all income grows at 7 percent, for two hypothetical tax systems — a progressive California-style system with marginal rates graduated from 2 percent to 9.3 percent, and a relatively flat Indiana-style system with a rate of 3.4 percent.[10] Assuming that capital gains fall by 30 percent from the previous year in both California and Indiana, Boyd estimates that tax liabilities would fall by 8.5 percent in California and by 3.6 percent in Indiana. For a more complete description of this analysis, see Boyd, *State Fiscal Issues and Risks*, pp. 11, 12.

Which states are most at risk if capital gains income declines? TABLE 4 suggests which states might be most harmed. The first column of numbers shows capital gains in each state as a percentage of adjusted gross income, adjusted for state-specific exclusions of capital gains, indexed to the national average, yielding a

Table 4
Relative Importance of Capital Gains:
Selected States

State	Adjusted Index of Capital Gains as Percent of AGI (1)	Index of Income Tax as Percent of General Revenue (2)	Index of Capital Gains Importance (3) (1) x (2)
United States	100.0	100.0	100.0
Colorado	120.2	145.0	174.2
Oregon	105.0	163.3	171.5
New York	123.3	131.1	161.7
Connecticut	131.8	121.5	160.1
California	110.7	126.1	139.6
Minnesota	83.9	156.4	131.2
Massachusetts	76.5	169.8	130.0
Virginia	86.6	147.2	127.4
Idaho	102.4	117.8	120.6
Maryland	82.5	143.4	118.3
Wisconsin	39.4	151.1	59.6
Louisiana	85.0	64.9	55.2
New Mexico	85.9	60.5	51.9
South Carolina	49.0	101.3	49.7
Arkansas	47.2	96.3	45.4
Mississippi	70.8	56.4	39.9
West Virginia	49.9	73.3	36.6
North Dakota	68.7	37.9	26.0
New Hampshire	127.2	10.6	13.5
Tennessee	90.5	5.4	4.9

Excludes: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

Source: Boyd, p. 12.

measure of the importance of capital gains to a state's income tax.[11 /, 12,13] The second column shows the income tax as a percentage of general revenue, indexed to the national average, yielding a measure of the income tax's importance to a state's finances.[14] The third column combines the first two, giving a measure of the importance of capital gains to a state's finances relative to the U.S. average.[15]

No simple index can take into account all of the important ways in which the stock market or capital gains affect the income tax. This index simply takes into account the direct role of capital gains income. It does not include indirect effects of the stock market such as its role in driving up taxable wage income for people compensated partly in stock options, and it does not include the impact of bonuses paid to those who benefit directly from financial market activity, such as investment bankers, although it may serve as an imperfect proxy for the former.[16] Finally, it does not take into account the indirect risk that would result if a stock market decline affected the earnings of investment banks and other financial market participants and if it affected the economy more broadly. With that said, the index does suggest which states are at greatest direct risk from a falloff in capital gains.

Colorado is at greatest risk, with an index of 174 — by this measure, capital gains are about 74 percent more important to its finances than they are to the average state. This results from a large amount of capital gains relative to AGI (20 percent above the U.S. average) plus relatively higher reliance on the income tax (45 percent above the U.S. average). Oregon, New York, Connecticut, and California round out the five states at greatest risk.[17] The states without an income tax obviously are not at risk by this measure.[18] When would states be hurt if the stock market fell? Even this is an uncertainty. Individuals compute their taxes on a calendar year basis, and generally pay taxes related to capital gains on an estimated basis during the year, settling when they file their returns the next April. State fiscal years generally end in June, so if capital gains income fell in calendar year 2000, tax payments would be depressed in the fiscal year beginning in July 2000 and ending in June 2001. Some analysts believe, however, that if a market decline is relatively small, then capital gains might actually increase in the year of the decline due to efforts by people to lock in gains before they vanish. Meanwhile, if capital gains were strong in 1999 as many analysts expect, due to the strong stock market in that year, then states will benefit in the fiscal year that ended in June 2000.

The point of the analysis in this section is that although the income tax has been an extraordinary revenue raiser for states in the 1990s, it is extremely volatile and states cannot expect the growth to continue at the pace seen in recent years. Furthermore, income tax revenue can reverse more sharply than intuition might suggest, even in states with relatively flat taxes. States that are highly reliant on the income tax or whose taxpayers have large amounts of capital gains are at special risk of unpleasant revenue surprises.

The Sales Tax

The sales tax shares first place with the income tax in state revenue systems, and plays an important role in local revenue systems. Unlike the income tax, the sales tax has no federal counterpart. States consider it their province, and have long taken offense at federal attempts to limit or usurp state sales taxing power. Thus, state officials often oppose federal proposals to establish a national retail sales tax or consumption-based tax, or efforts to limit states' ability to tax transactions related to the Internet.

One strength of the sales tax as a means of financing government is that it tends to be less volatile than the income tax. TABLE 3 presents estimates of sales tax cyclical elasticity, also prepared by Dye and McGuire, and in general the sales tax has less short-run elasticity than the income tax — the highest elasticity, lowest elasticity, and median elasticity all are lower than their income tax counterparts.

As with the income tax, however, a point estimate of elasticity can give a misleadingly benign impression of volatility, because elasticity varies over the business cycle. People postpone nonessential purchases during recessions so that the sales tax tends to fall off more sharply than income, and during recoveries people unleash pent-up demand, thereby increasing consumption and sales tax revenue more rapidly than income. The major point of the discussion to this point is that the sales tax, although less volatile than the income tax, is more volatile than simple elasticity estimates might suggest, and entails considerable risk to state finances.

Although the sales tax has not been growing as rapidly as the income tax during the 1990s, and so has become relatively less important, it has still grown in relation to the economy and its growth appears quite strong. This strength is deceiving. In fact, according to economists Donald Bruce and William Fox of the University of Tennessee's Center for Business and Economic Research, the sales tax base has been eroding for decades: "For the average sales taxing state, the tax base equaled 51.4 percent of the state's personal income in 1979, but had fallen to 42.8 percent in 1998."[19] When viewed over the long term, sales subject to tax have been declining relative to the overall economy.

According to Bruce and Fox, there are three main reasons for this long-term decline in the sales tax base. Probably the most important reason is that people have been shifting their consumption away from goods and toward services — and within services, to medical services and other services that are especially difficult to tax politically, legally, and administratively. A second reason for sales tax base erosion is the growth of "remote sales" — the general term for mail-order sales, sales conducted over the Internet, and other sales in which buyer and seller conduct the transaction at a distance. Although most such sales are technically subject to tax, and the buyer is legally responsible to pay "use" tax, the administrative and political hurdles to collecting the tax are severe, and states collect little of this tax except where they have the ability to require or persuade the seller, such as L.L. Bean, to collect and remit the tax on behalf of the buyer.

According to Bruce and Fox, the third reason the sales tax base has been eroding is that legislators in essentially every state have narrowed the tax base through new exemptions.

How can the tax base be shrinking if sales tax collections have been rising strongly in the 1990s? The erosion has been masked by two factors. First, policymakers raised sales tax rates, especially in the early 1990s, no doubt partly in reaction to base erosion and of course in response to the recession. Second, people have been saving far less of their incomes in the 1990s than in earlier decades, and spending far more. Some of this decline probably reflects a "wealth effect" from the strong stock market — when people's net worth increases they don't feel a need to save as much.

Should states expect further declines in the savings rate to prop up sales tax revenue, or is the rapid growth of the 1990s likely to moderate? While it is possible for the savings rate to decline further, and even become negative, it does not seem prudent to forecast this, given that the savings rate is so far below its level of preceding decades and that stock market values appear by some measures to have a lot of downside risk. Even if the savings rate does not rise, and merely stays at its 40-year low of 2.3 percent, then the boost to consumption and sales tax growth from a declining savings rate will end.

Donald Bruce and William Fox project that the long-term sales tax base erosion will continue, apparently due to continued shifts toward consumption of goods and services that are not taxed or for which tax is difficult to collect. They project that the loss between their base year of 1996 and 2003 will be about 1.75 percent of total tax revenue for the typical state, ranging from zero in those states without sales taxes to 3.3 percent in Florida, a state that is highly reliant on the sales tax.[20]

These projections simply reflect a continuation of longer- term base erosion, and are before considering revenues lost to state and local governments due to potential inability to collect tax on transactions conducted over the Internet. Bruce and Fox then prepared estimates of the revenue states stand to lose if e-commerce continues to grow rapidly. The estimates, shown in TABLE 5, assume that sales made over the Internet are subject to normal sales tax rules, but that a substantial portion of the tax on these sales may go uncollected nonetheless because purchasers, knowingly or

Table 5
Fiscal Year 2003 Estimate of State and Local Government Revenue Loss
Due to Electronic Commerce

State	Estimated Loss as Percent of Sales Tax	Sales Tax as Percent of General Revenue	Estimated Loss as Percent of General Revenue	State	Estimated Loss as Percent of Sales Tax	Sales Tax as Percent of General Revenue	Estimated Loss as Percent of General Revenue
Nevada	4.30%	38.70%	1.70%	South Carolina	4.26%	18.90%	0.80%
Florida	4.34	35.20	1.50	Nebraska	4.27	18.30	0.80
Texas	5.17	24.90	1.30	Maryland	5.49	14.20	0.80
Tennessee	4.34	28.70	1.20	Kentucky	5.06	15.10	0.80
Washington	3.14	36.10	1.10	Pennsylvania	4.41	17.20	0.80
Mississippi	4.42	24.30	1.10	Wisconsin	4.46	16.90	0.80
Oklahoma	7.30	14.60	1.10	Ohio	4.40	17.00	0.70
Hawaii	3.99	26.40	1.10	West Virginia	5.28	13.80	0.70
Utah	4.74	21.40	1.00	Maine	4.25	16.80	0.70
Minnesota	5.36	18.10	1.00	New Jersey	4.22	16.40	0.70
South Dakota	4.45	21.40	1.00	North Dakota	5.23	12.80	0.70
Michigan	4.44	21.10	0.90	Virginia	5.64	11.70	0.70
Illinois	5.58	16.50	0.90	Colorado	4.59	14.20	0.70
New Mexico	4.77	19.30	0.90	North Carolina	4.53	14.10	0.60
Georgia	4.61	19.90	0.90	Rhode Island	4.38	14.00	0.60
Kansas	4.39	20.30	0.90	Vermont	6.79	9.00	0.60
Missouri	4.63	18.80	0.90	Alabama	4.09	13.10	0.50
California	4.51	19.20	0.90	Massachusetts	4.40	12.10	0.50
Indiana	4.52	19.00	0.90	Wyoming	4.64	10.30	0.50
Arizona	3.44	24.80	0.90	New York	4.37	9.80	0.40
Arkansas	4.31	19.60	0.80	Alaska	not estimated	not estimated	not estimated
Connecticut	4.15	20.00	0.80	Delaware	no tax	no tax	no tax
Louisiana	6.08	13.50	0.80	Montana	no tax	no tax	no tax
United States (Median)	4.45	18.10	0.80	New Hampshire	no tax	no tax	no tax
Idaho	4.41	18.30	0.80	Oregon	no tax	no tax	no tax
Iowa	4.49	17.90	0.80				

Source: Based on estimate in Donald Bruce and William Fox, "E-Commerce in the Face of a Declining Sales Tax," University of Tennessee at Knoxville, February 2000.

otherwise, evade sales tax and because it is difficult for states to enforce compliance with tax on these items. Revenue losses would be greater still if the federal government prevented states from taxing purchases made over the Internet. Revenue losses would be lower if states and industry, or if states and the federal government, develop rules and procedures to facilitate compliance with use tax laws.

Bruce and Fox developed state-by-state estimates of potential revenue loss by 2003 using detailed forecasts of e-commerce transactions developed by Forrester Research, a market research firm, and employing assumptions about the extent to which these transactions would be potentially subject to tax, and the extent to which purchasers would evade taxes. The Forrester Research forecasts on which the revenue-loss estimates are based assume that commerce over the Internet will grow by 84 percent per year between 1999 and 2003. The revenue-loss estimates are presented in Table 5, modified to show potential revenue loss as a percentage of state general revenue.[21]

View the estimates with caution: although they appear to have been prepared carefully using reasonable assumptions, no one can predict with much confidence how rapidly e-commerce will grow over the next several years, or the extent to which e-commerce will be used for transactions on which sales tax would be paid in the absence of e-commerce. Furthermore, estimates for 2003, even if accurate, reflect a very early period for the Internet. If electronic commerce continues to grow as a share of total commerce for many years after 2003, as seems plausible, then the revenue loss to states over the longer run could be far larger than these estimates suggest.

These estimates suggest that the revenue loss from inability to tax e-commerce transactions would not be huge in the next several years, although it clearly would be noticeable in several states — a revenue loss as large as 1.7 percent of revenue in Nevada certainly would be enough for budget officials to worry about. States regularly have policy disputes over amounts as little as 0.5 percent of the budget, or less.

The estimates suggest relatively little variation across states in propensity to use the Internet for e-commerce (they assume that people in states with high sales tax rates are slightly more likely to use e-commerce to evade taxes than people in states with low tax rates). As a result, most of the variation in total revenue loss depends on the extent to which states rely on the sales tax — states that are heavily dependent on the sales tax have greater fiscal risk from e-commerce than states that are not. Hence Nevada, Florida, Texas, Tennessee, and other high-sales-tax states — usually with low or no income tax — appear at greatest risk of revenue loss due to e-commerce.

The point of this analysis is that the sales tax, which is a mainstay of state finances, is under attack. The attack has been partly masked by state rate increases and by an extraordinary decline in the savings rate — a decline that could stop, and could even reverse. Over the longer term the attack will continue and intensify. As living standards continue to rise and as the population ages, people are likely to continue shifting their consumption toward services. Growth of commerce over the Internet — commerce that is difficult to tax — probably will accelerate. The sales tax is at risk, and those states that are most reliant on the sales tax — especially those without income taxes — have the most at risk.

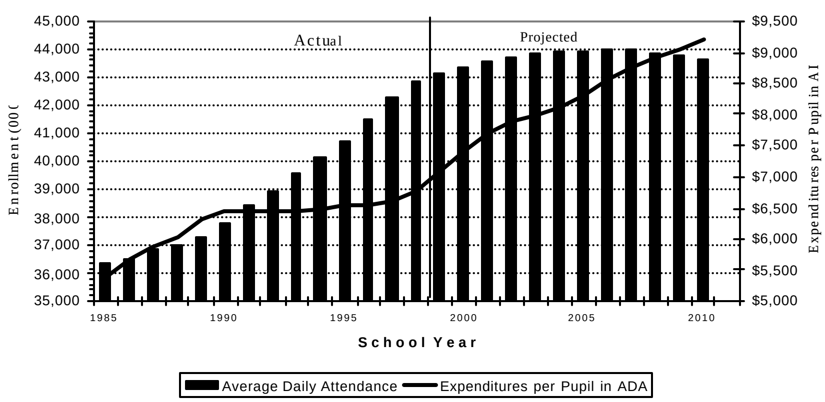
Key Expenditure Issues

Elementary and Secondary Education Spending Between the 1990 and 1997 state fiscal years, state governments increased real spending on elementary and secondary education by 14 percent. Most of this growth has come in the last several years. At the start of the decade, states were struggling with recession-induced revenue shortfalls and wildly escalating Medicaid cost, and were cutting back on education spending. Although we do not have complete data after 1997, it is clear that education remains a major priority in state budgets and that it has increased faster than other areas of state spending in 1998, 1999, and again in 2000.

FIGURE 3 shows trends in real state-local per-pupil spending along with actual enrollment and projections by the National Center on Education Statistics (NCES) for the 1998 school year and beyond.[22]

As the graph shows, enrollment grew sharply from the mid-1980s through the present as the children of baby boomers went to school. NCES projects that the most rapidly growing period of this baby boomlet is now past, and that enrollment growth has already begun to slow. NCES expects enrollment to grow at rates of less than 1 percent annually for the remainder of this decade, and to decline after the 2007 school year. Thus for the nation as a whole, it does not appear that enrollment will place significant pressure on school finances, or on the portion of school spending financed by state governments. Nonetheless, enrollment will grow quickly in some states and especially in the South and West, and especially in high-immigration urban areas.

Figure 3
Average Daily Attendance in Public Schools (K - 12) and
Current Expenditures per Pupil in ADA in Constant 1998-99
Dollars: School Years 1985 to 2010



Source: U.S. Department of Education, National Center for Education Statistics.

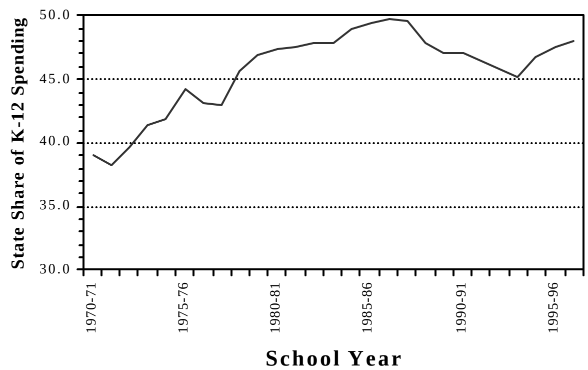
The outlook is less clear for per-pupil spending. Real per-pupil spending has been increasing sharply for decades now, although the graph shows that it did dip briefly in the 1990-91 recession, and that it has increased only slightly since then. The rapid growth in per-pupil spending, combined with lackluster student performance on standardized tests, led to questions about the value of the spending and to calls for accountability.

Recent years have seen a flurry of new state policies intended to lead to improved student performance. States have embarked on a new round of standards setting, with many states debating and adopting more stringent testing programs and graduation requirements. In addition, many states are reducing class sizes, and raising teacher certification standards. In some states there is also a backlash against social promotion.

While no data appear to be available on the costs of these policies, inevitably they will be expensive. NCES projects real per-pupil spending to increase from approximately $7,000 in 1998 to approximately $9,300 in 2010 (Figure 4). If scaling back social promotion and setting higher standards means that more students are held back or must attend summer school, then schools will need more teachers. With the stakes for students so high, schools are likely to spend more to provide tutoring and special preparation for exams. If states reduce class sizes, they will need more teachers. If states make entry into teaching more difficult, that is likely to place pressure on schools to raise teacher salaries.

Will states share in these higher costs, or will they scale back their contribution to education financing? As FIGURE 4 shows, except for a brief period in the late 1980s and early 1990s when states reduced their contribution to education financing, the longer-term trend has been for states to pay for an increasing share of education costs.[23]

Figure 4 State Share of Public Elementary and Secondary Education Costs: School Years 1969-70 to 1996-97



Source: U.S. Department of Education, National Center for Education Statistics.

The recent trend has been driven by several objectives: Many state school finance systems have been under legal attack — in fact, at the end of 1999, litigation was pending in 43 states. Litigants frequently argue that the state financing system violates provisions in the state constitution requiring it to ensure adequacy or equality in school funding. Many states have failed their constitutional tests. Both in response to court orders and to preempt potential court action, states have been increasing their share of funding, increasing the level of funding, and often making it more equal across school districts. A second factor leading states to increase their share of school funding has been the pressure to cut local property taxes. For example, Michigan increased substantially the state share of school funding after eliminating the local school property tax, and Oregon increased its share of school funding after voters passed an initiative imposing severe limits on the ability of local governments to raise property taxes. Litigation-related efforts to raise the state contribution to school funding and property-tax-reduction efforts appear likely to continue for the foreseeable future, so states will bear a considerable and perhaps increasing share of the new education costs related to higher standards.

Medicaid Appears Poised for Moderate Acceleration

Medicaid is the second-largest component of state spending. Total spending rose extremely rapidly in the early 1990s, contributing to recession-related fiscal crises, but growth since then has moderated considerably. TABLE 6 on the following page summarizes recent growth in total spending (federal and state combined), excluding certain payments known as disproportionate share payments.[24]

Table 6 Growth in Nominal Medicaid Spending in the 1990's	
Federal Fiscal Year	Average Annual Growth
1990-92	18.4%
1992-95	10.9
1996	5.3
1997	4.0
1998	6.0
1999	6.5

Sources: 1990-97 calculated from Bruen and Holahan, excluding disproportionate share; 1998 and1999 are outlay estimates from the Congressional Budget Office, p. 93 and are not precisely comparable with 1990-97.

The rapid growth in the early 1990s was driven by rapid enrollment increases, health care price inflation that exceeded general price inflation, and state efforts to shift services into the Medicaid program. In the 1992-95 period, enrollment growth slowed and health care price inflation moderated.

The further slowdown in 1996 and 1997 reflects outright enrollment declines in both years, low health care price inflation, growing use of managed care, and possibly the greater use of home and community-based long-term care. Enrollment declines were concentrated among low-income adults and children. According to an econometric analysis by The Urban Institute, the declines were caused by changes in states' welfare policies and an improving economy (with the welfare-reform-related declines occurring despite the fact that pre- welfare-reform Medicaid eligibility rules remained in effect).[25] The spending slowdown also reflected somewhat slower growth in the number of elderly and disabled enrollees, for whom Medicaid-financed health care is extraordinarily expensive.[26]

According to the Congressional Budget Office, the re- acceleration of Medicaid spending in 1998 and 1999 " was in part the result of higher spending for relatively more costly services such as pharmaceutical products and noninstitutional long-term care (for example, home health care). Another factor pushing up spending was that states expanded eligibility for the program and began again to serve some adults and children who had lost Medicaid coverage as a result of welfare reform."[27]

Has Medicaid entered a new, slower-growth regime, or is the modest acceleration since 1997 a harbinger of further acceleration in the future, and perhaps even a return to Medicaid's old budget-busting ways? Medicaid and health care experts seem to believe that many factors will continue to result in real growth in Medicaid costs.

- According to analysis by The Urban Institute, there is some evidence that welfare-reform-related enrollment continued to decline in 1998, but this could turn around in the near future. Some states have been working to streamline procedures and improve outreach, and states are identifying children eligible for Medicaid as they implement the State Children's Health Insurance Program (S-CHIP).[28]
- The Congressional Budget Office projects that federal Medicaid expenditure growth will average 8.5 percent annually from 1999 through 2010, or 6 percent above their forecasted 2.5 percent rate of inflation (Consumer Price Index).
- The Health Care Financing Administration projects that state-local Medicaid expenditure growth will average 8.1 percent annually from 1999 through 2008, or 5.3 percent above their 2.8 percent forecasted rate of inflation (GDP deflator).[29]

- In a project for the Robert Wood Johnson Foundation, the Institute For The Future, a nonprofit research organization in Menlo Park, Calif., forecasted that Medicaid spending would increase by 8 percent annually over the next 7 to 12 years. They expect factors that led to a slowdown in overall health care costs in the 1990s to continue, and they expect relatively little effort by states to expand coverage, except for children.[30]

While forecasting Medicaid spending is error-prone, the analyses discussed above suggest that in the next 5 to 10 years Medicaid costs will grow far more slowly than in the early 1990s but more rapidly than in recent years, perhaps averaging 5 to 6 percent above general price inflation.

It is hard to provide insight into which states will face the greatest budgetary pressures from changes in Medicaid spending. States with the fastest-growing populations, such as those in the South and the West, are likely to have the fastest-growing enrollments, but these states also tend to spend less on Medicaid per enrollee than do Northeastern and Midwestern states. Furthermore, different kinds of enrollees have different expenses, with the elderly and disabled being far more expensive to care for than low-income adults and children. States that expand eligibility rapidly may not necessarily face the greatest increase in costs.

Higher Education

Higher education, which in 1997 accounted for 12 percent of state spending and was the third-largest spending area, appears headed for modest growth. The National Center for Education Statistics projects that enrollment in public higher education institutions will rise by approximately 1 percent annually between 1999 and 2009, or about the same rate as the overall population. This is reasonably consistent with the Census Bureau's projections of the prime college-age population (17-24 years old). It is quite a bit lower, however, than the estimate of 1.9 percent average annual growth used in the National Education Association report (see the section entitled "Recent Studies of the Fiscal Outlook for States"), which was based on the NCES projected growth rate for high school graduates rather than their projections for college attendance. In any event, the data we have available suggest that higher education should not place especially significant pressure on state finances in the coming decade.

Other Issues

Government's primary function is as a service provider, and as such it seems to suffer a malaise that the economist William Baumol called "cost disease." It is hard to improve productivity in the provision of many services. The classic example is the barber who took 30 minutes to give a haircut 40 years ago, and takes 30 minutes to give a haircut today. In the intervening 40 years, manufacturers and other industries made huge productivity gains — the real cost of a stereo has come down, the real cost of a car (adjusted for changes in quality) has come down, and the real cost of computers has come down. But it still takes 30 minutes to get a haircut, and perhaps it still takes 30 minutes at the motor vehicles bureau to renew an automobile registration. The price of many services, relative to goods, has gone up — inflation in service industries tends to be faster than inflation in goods industries.

But to what extent will this be true in the future? Service businesses seem to be making many productivity gains now as a result of the Internet, and perhaps the Internet will lead to productivity gains in government, reducing the effective price of some governmental services. If people can renew their car registration online, or get a college degree at a virtual campus where one professor teaches hundreds of students rather than 10 or 20 students, then the price of some government services may fall. Obviously it is far too early to predict whether and to what extent this will be a significant factor in government finances.

Summary and Conclusions

One important lesson of the earlier tax revenue discussion is that each of the two major taxes has strengths and weaknesses as a means of financing government. From the perspective of fiscal stability, a diversified tax base is a good tax base.

The income tax can grow very rapidly in good times, but it is extremely volatile and at risk of sudden and unpleasant reversals. The risk appears especially great now given the enormous run-up in financial markets and the extraordinary growth in the number of very- high-income taxpayers.

While the sales tax can be volatile, especially during recessions, its main problem is that it is hard to administer and enforce when imposed on services or on goods ordered from out-of-state. Because services and remote sales are areas of rapid growth, the sales tax base has been subject to long-term erosion. Unfortunately for states, these trends are likely to continue, and the trend toward commerce over the Internet is likely to accelerate, meaning that erosion will continue and accelerate. While states can strive and hope for an acceptable resolution of e-commerce taxation, it is worth remembering that high reliance on the sales tax intensifies the risk.

States that rely very heavily on taxes other than sales and income taxes, especially taxes that are imposed on narrow segments of the economy, run greater risk of fiscal booms and busts. The relatively few budget problems we saw in the mid- and late 1990s usually can be traced in large part to heavy reliance on taxes other than income and sales taxes. For example, Alaska and Wyoming had fiscal problems related to weakness in oil and mineral industries, and New Hampshire had difficulty financing court-mandated education funding due to its lack of an income or sales tax.

From the perspective of fiscal stability, states were both lucky and good in the 1990s. They were lucky in that the economy, financial markets, and revenue grew far faster than they expected, and fast enough to more than make up for structural weaknesses in their revenue bases. They were good in that they rebuilt reserves that had been depleted after the last recession, raising them to a 20-year high — a high that would not, unfortunately, be sufficient to withstand even a modest recession.

Looking forward, states face a number of substantial risks to their revenue structures. The income tax has benefited from extraordinary growth in nonwage income and in the numbers of taxpayers in top tax brackets. Unfortunately, this sort of income is fragile and has a habit of declining sharply in recessions and during financial market declines. The income tax has become more volatile and more subject to downside risk.

The five states with the most direct risk to their revenue structures if financial markets decline for a prolonged period are Colorado, Oregon, New York, Connecticut, and California, based on the direct importance of capital gains to their revenue structure in 2000. Many other states would face substantial risk as well, especially if a market decline led to trouble in the financial services industry and to slowing in the broader economy.

At the same time that the income tax has become more volatile, it has become potentially more important. The sales tax base has been eroding, although it was propped up in the 1990s by a sharp increase in consumption relative to income — a decline in the savings rate — driven partly by exploding stock market values. The sales tax is likely to continue to erode due to the aging of the population and the continued shift toward service consumption. The erosion could accelerate significantly depending on how the issue of taxing goods and services purchased over the Internet is resolved.

Based on work by Donald Bruce and William Fox of the University of Tennessee, Nevada, Florida, Texas, Tennessee, and Washington are the five states that appear to have the greatest near-term revenue risk if states cannot collect taxes on electronic commerce, but many states would face substantial risk over the longer term.

The impact of financial market exuberance has pervaded state revenue systems. It has led to skyrocketing capital gains, higher wage-like income as a result of incentive stock options, higher distributions from retirement accounts that have swelled due to higher stock values, and faster sales tax collections due to the "wealth effect" and its impact on consumption. If the financial markets were to turn down significantly, all of these effects would reverse, probably quite sharply.

The spending side of the state budget actually looks relatively benign. The largest spending area, elementary and secondary education, will benefit from slowing enrollment growth compared with the 1990s. However, although taxpayers may be suffering exhaustion from the large per-pupil spending increases of the last several decades, virtually all of the education policies currently being adopted will lead to higher, not lower, spending. With many states moving to fund a larger share of total education spending, they are likely to face policy-driven pressure to increase state education spending. The second-largest spending area, Medicaid, appears to have recovered from a recent slowdown and now is poised for faster growth, albeit more moderate than in the early 1990s. These two large spending areas will place pressure on state finances, but it is unlikely to be as significant as in the late 1980s and early 1990s.

We believe state reserve funds fall far short of what would be needed to maintain spending without raising taxes, although many would disagree with this as a standard. States may keep reserves below the level needed to maintain spending in a recession for a number of reasons. For example, reserves can be hard to safeguard: the mere act of establishing reserves makes them visible, and subject to attack by groups who would rather use the money for spending or for tax cuts. Some states might prefer to use less-visible measures to smooth out finances during a recession, such as internal borrowing, revenue accelerations, and spending delays. But judging by the last two recessions, these relatively subtle mechanisms are limited, and after states exhaust the reserves they do maintain, they usually have to resort to much more severe actions such as spending cuts or tax increases.

The overall picture is one of considerable risk to state budgets, mostly on the revenue side: the extremely rapid income and sales tax growth rates of the 1990s are almost certainly unsustainable and are likely to slow sharply in coming years. This could make it very difficult for states to finance even moderate growth in spending.

ENDNOTES

[1] In estimates reported to the National Association of State Budget Officers, states indicated their intent to draw reserves down in fiscal 1999, and again in 2000, but we did not include these estimates in our graph because recent history has shown that even when states intend to draw down reserves they end up increasing them if revenue collections exceed expectations, as is likely to have occurred in 1999 and 2000.

[2] States tend to increase taxes after a recession ends, as it takes time to respond to unanticipated bad news. Therefore, we count tax increases occurring shortly after a recession ends as recession-related increases.

[3] Even income taxes that are fully indexed for inflation can be elastic — real incomes rise in most years due to productivity gains, driving taxpayers into higher effective-tax-rate brackets. Even "flat" taxes are progressive and elastic if they have a zero bracket amount or standard deduction, since that will lead to higher average rates as income rises.

[4] The numbers in this section are based on the data files 97in01ag.xls and 97in02ag.xls obtained from the Statistics of Income Web page on the U.S. Treasury's Web site.

[5] Dye, Richard F., and Therese J. McGuire. "Block Grants and the Sensitivity of State Revenues to Recession." Proceedings of the 90th Annual Conference on Taxation, 1997. Washington, National Tax Association, 1998.

[6] Technically, a high elasticity of nominal tax revenue to nominal income might suggest rapid revenue growth even in a slowing real economy, if nominal income growth is positive. But as the discussion that follows makes clear, elasticities are not fixed, and the nominal elasticity is likely to fall in such a circumstance.

[7] Center for the Study of the States. Davis, Elizabeth I. and Donald J. Boyd. "Does December-January Revenue Signal a Strong April 2000?" State Revenue Report No. 39. Nelson A. Rockefeller Institute of Government. Albany, N.Y., March 2000. (This report also appeared in State Tax Notes, Apr 3, 2000, p. 1203; at 2000 STT 64-38.

[8] Congressional Budget Office. The Budget and Economic Outlook: Fiscal Years 2001-2010. Congress of the United States. Washington. January 2000. It also is a good discussion of how rising financial asset values have impacts throughout the tax system, not just in the capital gains component of adjusted gross income.

[9] California Legislative Analyst's Office. "The 2000-01 Budget: Perspectives and Issues." Report from the Legislative Analyst's Office to the Joint Legislative Budget Committee. 2000, p. 42.

[10] The numbers in the table are obtained by applying the tax rate schedule for each hypothetical tax system to average taxpayers in each of several income classes, using the actual national income distribution in 1997 based on data from the U.S. Treasury Department's Statistics of Income Division. The estimates assume 2 percent growth in the number of returns, 5 percent growth in non- capital-gains income, 4 percent growth in exemptions and deductions, and 5 percent growth in capital gains in the baseline case and a 30 percent decline in the gains-falloff case.

[11] Most states with income taxes adopt federal definitions of income, and most of those states include substantially all realized gains fully in income. Some states, however, exclude large amounts of capital gains from tax, and the index has been adjusted to account for this. Arkansas excludes 70 percent of capital gains from income; South Carolina excludes 44 percent of capital gains held for two or more years from income, which we estimate amounts to an exclusion of 34.7 percent of total gains (short term plus long term); and Wisconsin excludes 60 percent of net capital gain from assets held more than one year, which we estimate excludes 53.3 percent of total gains. Massachusetts is phasing down its tax on capital gains so that in the 2001 tax year the rate on gains from assets held six or more years will be zero, with rates ranging up to 5 percent for long-term gains held for shorter periods, and with a rate of 12 percent on short-term gains. We estimate that in tax year 2000, this rate schedule is comparable to a 39.3 percent exclusion of total capital gains. In a draft of this report based on the 1999 tax year, provided to and cited in the Wall Street Journal, the estimated exclusion was only 18 percent, leaving Massachusetts with the highest capital gains risk of any state given its high level of realized gains and its high reliance on the income tax. With the new estimates, based on the 2000 tax year, Massachusetts still has high capital gains risk, but well below the 1999 estimate, dropping it from first place to seventh place. In addition, the previous estimates did not capture the Wisconsin exclusion.

[12] The national average for capital gains as a percentage of adjusted gross income was 7 percent.

[13] We consider this more than just a measure of the direct importance of capital gains, but rather also a measure of the importance of financial markets to state finances.

[14] The national average for the income tax as a percentage of revenue was 18 percent.
[15] This measure ignores the role of progressivity and treats two states with the same amount of capital gains, relative to adjusted gross income, the same. In fact, if one of these states has a more progressive tax than the other, capital gains will be more important to that state's income tax since gains are concentrated in upper income brackets.
[16] It also does not take into account differences in tax progressivity across states. Since capital gains are highly concentrated among very-high-income individuals, states with very progressive income taxes, such as California, could be at greater risk than the index suggests.
[17] New Jersey's relatively low position on the list is surprising. It is a relatively high-income state, with a distribution of income that is more skewed toward high-income taxpayers than the national average. Nonetheless, the data show New Jersey with only about 85 percent of the national average amount of capital gains as a share of adjusted gross income in 1997. This is not just an artifact of the 1997 data year -- it was also true in 1996, and again in 1998 according to data for 1998 made available by the Statistics of Income branch of the U.S. Department of the Treasury. The data show that New Jersey's relatively low level of capital gains reflects lower average capital gains at every level of income than in the nation as a whole, rather than fewer returns with capital gains. Staff of the Statistics of Income branch had no explanation for this seemingly surprising set of facts.
[18] Not surprisingly, states without income taxes generally have very high capital gains as a percentage of adjusted gross income.
[19] Bruce, Donald and William F. Fox. "E-Commerce in the Context of Declining State Sales Tax Bases." Center for Business and Economic Research, The University of Tennessee. Knoxville, Tenn. February 2000. Also see: Merriman, David and Mark Skidmore. "How Have Changes in Demographic and Industrial Structure Influenced Sales Tax Revenues?" Proceedings of the 90th Annual Conference on Taxation, 1997. Washington, National Tax Association, 1998.
[20] Bruce and Fox did not report an estimate for a "typical" state. The 1.75 percent figure is the median of the estimates for individual states.
[21] Bruce and Fox presented potential revenue loss as a percentage of tax revenue. We prefer to use the broader denominator of general revenue.
[22] http://nces.ed.gov/pubs2000/projections/Table43.html
[23] http://nces.ed.gov/pubs2000/digest99/d99t160.html
[24] Disproportionate share payments (DSH) are payments to certain hospitals that serve a disproportionate share of poor clients. In the early 1990s many states used these payments as a mechanism to obtain increased reimbursement from the federal government, and Congress subsequently curtailed these payments. When these payments increased rapidly, they actually reduced stress on state budgets, and when they subsequently declined rapidly, they increased stress on state budgets. Including DSH payments in total Medicaid spending would overstate the stress that Medicaid growth placed on state budgets in the early 1990s and understate the stress on budgets when Medicaid growth slowed due to curtailment of DSH. Total Medicaid spending including DSH payments grew by 27.1 percent on average in the 1990-92 period (rather than the 18.4 percent shown in the table) and grew by only 2.3 percent in 1996 (rather than the 5.3 percent shown in the table); the impact of excluding DSH is smaller in other years.
[25] Ku, Leighton and Bowen Garrett. "How Welfare Reform and Economic Factors Affected Medicaid Participation: 1984-1996." Discussion Paper 00-01. The Urban Institute. Washington. February 2000.
[26] This discussion is based on Bruen, Brian and John Holahan. "Slow Growth in Medicaid Spending Continues in 1997." Kaiser Commission on Medicaid and the Uninsured. November 1999.
[27] Congressional Budget Office, January 2000, p. 83.
[28] See Bruen and Holahan, p. 9.
[29] Smith, Sheila; Stephen Heffler, and the National Health Expenditures Projection Team. "The Next Decade of Health Spending: A New Outlook." Health Affairs 18 (1999), No. 4, pp. 86-95.
[30] Institute for the Future. Health and Health Care 2010: The Forecast, The Challenge. The Institute for the Future. Jossey-Bass Publishers. San Francisco. January 2000.

Recent Trends in State Finances

By Elliott Dubin, Director of Policy Research, MTC

More recent data on state fiscal conditions has become available since June 2000, when Dr. Boyd's study was published. These data tend to bolster Dr. Boyd's assessment that state will face fiscal risks in the coming decade. As shown in TABLE 1 (on page 35), appropriated fund balances in state budgets for fiscal year 2001 will fall by nearly 9 percent from the preliminary 2000 level, and by more than 25 percent from the actual fiscal 2000 level. Fund balances, as a percentage of general expenditures are expected to decline from 8.4 percent in 1999 to 5.6 percent in 2001.

The projected decline is not uniform among the states. Fund balances are projected to increase in 17 states – from 1.3 percent in Pennsylvania to 80 percent in New York. Conversely, fund balances are projected to nearly disappear or actually disappear in Alabama, North Carolina, Texas, Arkansas, and New Hampshire.

Further, Elizabeth Davis and Nicholas Jenny, Dr. Boyd's colleagues at the Rockefeller Institute's Fiscal Studies Program, find that the states are becoming more cautious about upcoming year's revenue growth and may delay further tax reductions. The authors note that although aggregate growth in withholding tax payments is still strong, several states noticed weakness in these payments. Furthermore, sales tax growth slowed considerably.

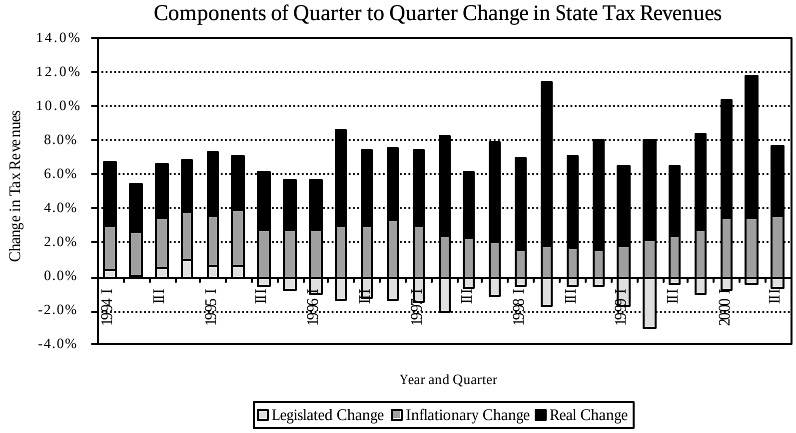
Overall, the growth in tax revenues from the third quarter of 1999 to the third quarter of 2000 was 7.1 percent, the strongest growth in third quarter revenues in 7 years. However, when revenue changes are adjusted for legislated changes and for inflation, real third quarter growth was 4.1 percent, down from 1998 (5.4 percent) and equal to 1999 (see FIGURE 1 below).[1]

The recent slowdown in revenue growth, coupled with permanent tax cuts and expenditure increases enacted in the past few years could have an adverse impact on state General Obligation (GO) bond ratings. Over the past eight years, strong revenue growth and a low interest rate environment have benefited the states as their GO bond ratings have generally been upgraded. Higher ratings allowed states to borrow more at lower interest costs. However, Jeff Petry, in a recent article in the *Dismal Scientist*®, notes that:

"Coupling a general economic slowdown and a higher interest rate environment with the present state fiscal situation points to rising fiscal stress for state budget makers. This combination of economic factors could also result in decrease in bond ratings further compounding any erosion in tax revenue."[2]

Petry notes that only Tennessee's GO bond rating was downgraded this year. Changes in state GO bond ratings in the near future will depend on the length and depth of the economic slowdown and actions of the Federal Reserve Board. ●

Figure 1
Components of Quarter to Quarter Change in State Tax Revenues



Source: Rockefeller Institute, Fiscal Studies Program

Table 1 Total Balances and as a Percentage of Expenditures[1]							
	Total Balances[2]			Percent	Total Balances as		
	Fiscal Year			Change	Percent of Expenditures		
	1999	2000	2001	1999-	Fiscal Year		
State	(millions)			2001	1999	2000	2001
U.S. Average	$39,101	$31,934	$29,147	-25.5%	8.4%	6.4%	5.6%
New York	892	1,170	1,606	80.0	2.4	3.2	4.2
Louisiana	-6	58	91	56.9[3]	-0.1	1.0	1.5
Hawaii	189	257	288	52.4	5.8	8.1	8.8
Washington	998	1,175	1,336	33.9	10.2	11.6	12.8
Montana	110	165	142	29.1	10.6	15.1	12.2
Vermont	40	41	46	15.0	4.8	4.8	5.4
Minnesota	1,921	2,370	2,167	12.8	17.5	20.5	17.6
Idaho	83	98	93	12.0	5.1	5.8	5.2
Illinois	1,351	1,350	1,485	9.9	6.3	5.9	6.2
South Dakota	35	37	38	8.6	4.8	4.8	4.8
Michigan	1,223	1,285	1,315	7.5	13.0	13.9	13.6
Oklahoma	383	411	411	7.3	8.6	9.0	8.5
Connecticut	529	563	567	7.2	5.0	5.0	5.0
Nevada	227	231	235	3.5	14.0	14.4	14.5
Utah	102	100	105	2.9	3.1	3.0	2.9
Tennessee	217	212	223	2.8	3.4	3.1	3.1
Massachusetts	1,604	1,706	1,647	2.7	8.7	8.7	8.4
Alaska	2,628	867	2,677	1.9	114.6	37.9	116.9
Pennsylvania	1,134	1,511	1,149	1.3	6.2	7.8	5.8
Ohio	1,175	1,322	1,136	-3.3	6.5	6.8	5.5
New Mexico	185	143	174	-5.9	5.8	4.2	5.0
Colorado	679	704	625	-8.0	11.6	11.8	9.6
Maryland	1,218	1,396	1,108	-9.0	14.3	15.5	10.9
Mississippi	360	300	307	-14.7	11.5	8.7	8.5
Virginia	847	1,065	700	-17.4	8.3	9.4	5.7
Kentucky	295	422	239	-19.0	4.5	6.5	3.5
Oregon	577	526	462	-19.9	14.0	10.8	8.8
Florida	1,694	1,704	1,232	-27.3	9.4	9.1	6.3
Iowa	728	574	528	-27.5	16.1	12.0	10.8
New Jersey	1,267	1,174	850	-32.9	7.0	6.0	4.1
Arizona	642	577	430	-33.0	10.9	9.6	6.7
California	3,708	3,012	2,430	-34.5	6.4	4.6	3.5
Kansas	541	318	333	-38.4	12.9	7.2	7.5
Nebraska	439	271	270	-38.5	19.6	11.6	11.3
Delaware	305	221	178	-41.6	14.2	9.5	7.2
Indiana[4]	1,992	1,617	1,059	-46.8	23.5	17.8	10.8
Missouri	499	435	216	-56.7	7.1	6.1	2.8
Maine	361	439	150	-58.4	16.8	18.9	5.7
Rhode Island	180	113	71	-60.6	8.8	5.1	3.1
West Virginia	221	81	81	-63.3	8.5	2.9	3.0
South Carolina	723	464	247	-65.8	15.3	8.7	4.4
North Dakota	62	41	21	-66.1	8.2	5.3	2.6
Wyoming	73	103	23	-68.5	14.6	18.4	3.7
Georgia	1,542	545	408	-73.5	11.8	3.8	2.8
Wisconsin	701	569	181	-74.2	7.0	5.8	1.6
Alabama	72	41	7	-90.3	1.5	0.8	0.1
North Carolina	819	38	37	-95.5	6.3	0.3	0.3
Texas	3,479	24	24	-99.3	6.6	0.0	0.0
Arkansas	40	0	0	-100.0	1.3	0.0	0.0
New Hampshire	20	0	-4	-100.0	2.1	0.0	-0.4

1. Data for 1999 are actual; data for 2000 are preliminary; data for 2001 are appropriated.
2. Total balances include both ending balances and balances in budget stabilization funds.
3. Change from fiscal year 2000 to fiscal year 2001.
4. Does not include $240 million in tuiution reserve fund.

Source: National Association of State Budget Officers, *Fiscal Survey of the States*, August 2000.

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[1]Elizabeth I. Davis and Nicholas Jenny "Third Quarter Revenue Still Strong But Signs of Weakness Appear," State Revenue Report, Fiscal Studies Program The Nelson A. Rockefeller Institute of Government, December 2000, No. 42.

[2]Jeff Petry, "State Fiscal Conditions Are At Risk," The Dismal Scientist. Com, http://www.dismal.com/todays_econ_te_110800.asp.

Sampling Techniques to Improve Sales and Use Tax Auditing

By Harold Jennings, Computer Audit Service Administrator

Traditionally, taxing jurisdictions have employed non-statistical or "judgmental" sampling techniques in conducting sales & use tax audits. Under a judgmental sampling technique known as "block" sampling, the sampling unit of choice in most instances has been the month. Many taxing jurisdictions require that for every 12 months under audit, one month be selected for audit. Hence, a state with a 36 month audit cycle requires that 3 months be selected for audit. Although there are a variety of reasons why state tax agencies have used the block sampling method, it is usually a matter of convenience, understanding and acceptance by both the taxpayer and the taxing jurisdiction.

Judgmental sampling refers to either the auditor or taxpayer selecting which months, *i.e.*, sampling units, are to be audited. The problem with judgmental sampling is that it allows for either auditor or taxpayer bias to enter the selection process. Such bias can be either intentional or unintentional and can taint the results of the audit, even where the parties have agreed upon the months selected.

When projecting results from judgmental sampling, there is no way to measure the standard error, or more simply put, no way to measure the accuracy of the results.[1] Any standard error determination from a judgmental sampling, is merely an auditor's best guess using the available information. In many audits, when the results are not within the parameters the taxpayer expected, the taxpayer will protest the audit. The end result usually will be some compromise, which may include expanding the audit by another month or more which can be very time consuming. Alternatively, the results might be thrown out and a new sample taken.

The following discussion will explain how sales and use tax audit sampling techniques can be improved by using improved non-statistical sampling and statistical sampling. The first element of improved sampling is the introduction of random selection. Rather than the auditor or the taxpayer selecting which months are to be examined, the selection should be done randomly. This eliminates any possibility or even the perception of selection bias.

The biggest improvement might be made in the sampling unit that is chosen. A sampling unit can be a unit of time or a unit of information. For statistical reasons, the smallest sampling unit that is practical should be used. The sampling unit in a monthly block sample is the month. In manual type audits, where electronic records are not available, the smallest sampling unit is usually the transaction (invoice). Where electronic records are available, the line item on an invoice is usually the smallest sampling unit that is practical.

The use of other sampling units, such as, day, week, or cluster of invoices, allows the auditor to use random selection to choose more sampling units to examine throughout the entire audit period. Larger sample sizes will improve the precision and reliability of the audit results. Compare the monthly block sample for a three-year audit period, where only three sampling units are examined, to the use of a randomly selected sample of transactions, where the transaction as sampling unit permits the examination of several hundred to more than a thousand sampling units in a three-year audit period. In non-statistical sampling, the degree of precision or reliability obtained in the audit is still not known. However, the auditor and the taxpayer can feel more comfortable with the results obtained using random selection and larger sample sizes.

Often in an audit using non-statistical sampling, the taxpayer may raise the issue as to whether the sample is representative of the population from which it is drawn. The term "representative" comes from the AICPA's Statement on Auditing Standards.[2] However, the SAS provisions do not provide any clear guidelines for determining the meaning of "representative."[3] As a matter of policy, the state should define what representative means and hold the sampling results to that standard. This should increase the comfort zone for the taxing jurisdiction and the taxpayer.

Even after this is done, we still do not know how reliable our sample is. Non-statistical sampling will never reveal this. In order to make this determination, statistical sampling has to be introduced.

We begin the discussion of statistical sampling with an examination of some of the elements needed for the successful use of statistical sampling in an audit:

1) The population of interest must be adequately determined and a sampling unit must be defined.
2) The population must be refined.
3) Correspondence must be established between the random number and the sampling unit.
4) The optimal sample size must be determined.
5) Every possible combination of sampling units must have an equal chance of being selected using randomly selected numbers.
6) The sample items must be audited.
7) The results must be evaluated statistically and projected to the population.

Items one and two also pertain to non-statistical sampling, however, defining and refining the population usually is accomplished unwittingly when using the monthly block. Anytime we introduce random selection we need to insure that we can identify the random number with a sampling unit (correspondence).

There are many considerations that go into determining the optimal sample size. The first question that is usually asked is "how large of a sample is needed?" The basic premise from a precision viewpoint is that "more is better." The larger the sample, the better the precision and the more reliable is the point estimate. This philosophy, however, can easily result in over sampling and place a heavy strain on critical resources. Besides the excessive cost and strain on audit resources, a sample that is much larger than it needs to be typically yields only a very slight improvement in precision when compared to a much smaller sample.

Once we determine how precise we need to be and how much of our resources we are willing to expend on sampling, we can mathematically determine our sample size. There are formulas for making this determination in a non-statistical sample, but they are not statistically based nor do they have anything to do with precision. In statistical sampling, every combination of sampling units must have an equal chance of being selected. For example, if you are examining non-taxed sales invoices then every non-taxed sales invoice in the entire audit period must have an equal chance of being selected.

Auditing the sampling units is the same whether doing non-statistical or statistical sampling. The auditor determines if an error has occurred and assigns a value to the sampling unit. The value could be $0 or any other value. The important thing is that each sampling unit has some value. As a matter of fact, most sampling units normally have a value of $0. We are generally dealing with populations that have only a 3% - 5% error rate, which means that the remainder of the items will be valued at $0.

One of the biggest advantages of statistical sampling is that after the sample items are audited, they are then statistically evaluated and projected to the population. In evaluating the sample we are able to determine how precise or reliable our estimate is and we can establish confidence intervals.

The confidence interval is what it implies, how confident you are that the true but unknown actual assessment lies between two points (i.e., the lower and upper limits). A higher confidence level will always cause a wider interval. An example of this is when I am 90% confident that my assessment lies between $100,000 (lower limit) and $500,000 (upper limit). In this case, the confidence interval is $400,000. There is also a 10% chance that the true but unknown assessment may lie outside these boundaries. Given the same facts, but in this instance I am 80% confident may well cause the interval to lie between $150,000 and $450,000, which gives me a confidence interval of $300,000. We also have a 20% chance that the true but unknown assessment lies outside these boundaries.

It is difficult to separate the discussion of precision from the confidence interval because they both have some degree of interconnection and have some effect on the assessment. The precision amount is added to and subtracted from the mid-point to obtain the upper and lower limits of the confidence interval. The larger the precision amounts, the larger the interval. In fact, the confidence interval is twice the amount of the precision amount. A better way of discussing the precision amount is in terms of percentage rather than dollars.

Better precision obtained in a sample results in a smaller confidence interval and thus a more reliable assessment. There are two things we can do to improve precision in most audits—one is to stratify the population (by dollars or some other variable) and the other is to draw larger samples. A good rule of thumb is, in order to cut the precision percent in half, quadruple the size of the sample.

So where do we go from here? Do we stay with the monthly block sample or do we use other non-statistical sampling methods or do we go one step further and do a statistical sample? The answer is to let the audit dictate which method you use. No one sampling method will be best for every audit whether non-statistical or statistical techniques are used. In order to make this determination auditors will need to be properly trained in both non-statistical and statistical sampling procedures. The MTC currently offers two sampling courses designed for state tax auditors, Non-statistical Sampling and Basic Statistical Sampling. Below is the schedule for the year 2001.

SCHEDULED NON-STATISTICAL SAMPLING CLASSES

Albuquerque, NM	February 5 – February 9, 2001
Sioux Falls, SD	March 5 – March 9, 2001
Cheyenne, WY	April 23 – April 27, 2001
Little Rock, AR	September 17 - September 21, 2001
Portland, ME	October 22- October 26, 2001

SCHEDULED BASIC STATISTICAL SAMPLING CLASSES

Columbus, OH	May 14 – May 18, 2001
Olympia, WA	June 18 – June 22, 2001

If your state might be interested in hosting a sampling training session or your state would like to send staff to one of the scheduled classes, please contact:

Harold A. Jennings
Multistate Tax Commission
Tel: 708-862-0388 or 312-913-9150
Fax: 708-862-2036 or 312-913-9151
E-mail: hjennings@mtc.gov.

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[1] The MTC Statistical Audit Manual defines “standard error” very technically to mean the standard deviation of the sampling distribution for a statistical estimator.

[2] “Statement on Auditing Standards (SAS) 39”, June 1981; American Institute of Certified Public Accountants (AICPA).

[3] SAS 39, Sample Selection, paragraph 24 states: “Sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. For example, random-based selection of items represents one means of obtaining such sample.”

Review and Summary of Recently Enacted E-SIGN Law

By René Y. Blocker, Deputy Director, MTC

Overview

The federal Electronic Signatures in Global and National Commerce Act (bill S.761) was signed into law on June 30, 2000, as Public Law 106-229, 114 Stat. 469 (codified as 15 U.S.C. §§7001-7006, 7021, 7031). The Act is popularly known as "E-SIGN." (Section references herein are to the Public Law version of the Act.) Its general provisions became effective October 1, 2000.[1] Under E-SIGN, electronic signatures and electronic records that are transmitted or produced as a result of transactions in or affecting interstate or foreign commerce are to be considered as legally effective, valid and enforceable as manual signatures and traditional paper records.

The purpose of the Act is to provide a consistent national framework for use and acceptance of electronic signatures and electronic records in interstate and foreign commercial transactions.[2] E-SIGN establishes that, "a signature, contract, or other record relating to [an interstate or foreign] transaction may not be denied legal effect, validity, or enforcement solely because it is in electronic form." Section 101(a)(1). The Act also provides that a contract formed using an electronic signature or an electronic record is to be afforded legal effect, validity or enforceability. Section 101(a)(2). E-SIGN ***does not require*** businesses or individuals to conduct their transactions electronically. The Act provides only that where parties agree to transact business electronically, the electronic form of commercial records are to be afforded the same legal effect, validity or enforceability as would be afforded traditional paper records.

The legislation specifically preempts any State or Federal law that requires handwritten signatures or requires the use of only paper records in transactions between private parties. E-SIGN has been adopted clearly as a prod to States to enact the Uniform Electronic Transactions Act ("UETA") recommended by the National Conference of Commissioners on Uniform State Laws in 1999.[3] (See insert "UETA—What have States done so far?" on page 41.) Thus, States may avoid the preemption under E-SIGN by adopting either the UETA or by conforming their existing electronic records laws to the provisions of the Federal Act. It is expected that the Federal preemption will be lifted once the States have either adopted UETA, or conformed their laws to E-SIGN.[4]

There are specific exceptions from the Act's requirement that electronic records be given the same legal validity as paper records. Statutes governing wills, codicils, *etc.*, and State statutes governing matters of family law that require handwritten records are not preempted by E-SIGN. Section 103(a)(1); (2). Nor are State Uniform Commercial Code provisions preempted by the Federal Act, other than the UCC provisions requiring written waivers of claim after contract breach and written evidence of sales of personal property valued in excess of $5,000.00 and UCC provisions related to sales and leases. Section 103(a)(3). E-SIGN also does not apply to: court orders and other official court documents; notices of utility service cancellation, foreclosure or eviction, health or life insurance termination or product recall; and documents required to accompany the transportation or handling of hazardous or toxic materials. Section 103(b). Additionally, E-SIGN does not prevent State or Federal regulatory agencies from specifying standards and formats for filings to be made with such agencies, including specifying that filings be made in writing. *See* Section 104(a).

Potential Effect on State Tax Administration

There will be a small ripple effect from this federal legislation on State tax administration. For the most part, the day-to-day operations of State tax agencies are not likely to change very much. The Act does not change State governmental requirements regarding the type of records that must be retained; the content of records; the duration for retaining records; the filing standards and timing for filing records; access by state agencies to such records or other records retention requirements. Section 104(a) explicitly provides that E-SIGN does not limit or supersede State or Federal agency requirements that "records be filed with such agency or organization in accordance with specified standards or formats." Thus, States can continue to require paper filings with its agencies. For example, State tax agencies may require vendor registration forms, tax returns, waivers, refund requests, *etc*., to be filed with the State in hardcopy form with handwritten signatures.

E-SIGN's preemption affects only government requirements addressing the form in which records related to commercial transactions between private parties must be produced or retained. This means a State may not mandate that records be kept in hardcopy and a State must therefore accommodate the possibility that the required records will be maintained electronically.

For State tax agencies, the Act most immediately affects existing records retention laws and rules concerning *the form* in which taxpayers must maintain and present their relevant records. Perhaps the most difficult task for State tax agencies will be reviewing their tax codes, rules and regulations to determine which have been preempted and specifically reviewing existing records retention and electronic signature provisions for their compliance with E-SIGN or the Uniform Electronic Transactions Act ("UETA").

It is obvious that State tax agencies can no longer require that taxpayers provide their transactional records in paper form with handwritten signatures, as long as the taxpayer produces electronic records that meet the other records retention requirements. State tax provisions requiring the retention of hardcopy originals also are preempted. *See* Section 101(d)(3). Consequently, State tax auditors are likely to be presented with more electronic versions of invoices, contracts, shipping documents, partnership agreements, exemption certificates and other relevant records exchanged between trading partners, all of which may have been signed with electronic rather than manual signatures.

It is not clear under E-SIGN whether a State can require hardcopy printouts of electronic records[5] or whether the State must have the means to review the records in their electronic form. Thus, States that desire to avoid confrontational refusals for the production of records will need to determine whether they need immediate improvement in their computer-assisted auditing and electronic records conversion capabilities in order to adequately handle electronic records. State tax auditors will have to be equipped with the hardware, software and knowledge to access and/or convert electronic records and recognize whether or not an electronic record is accurate and/or reliable.[6]

Reviewing a taxpayer's electronic records in audit may become less problematic as more State tax auditors acquire the experience and expertise to review electronic records and taxpayers become more comfortable with computer-assisted auditing. State attorneys and the courts may have a less comfortable transition to handling electronic records since the legal community continues to rely heavily on paper documents and handwritten signatures for evidentiary purposes.

Still, taxpayers remain under an obligation to retain accurate, readily accessible electronic records. E-SIGN requires that the retention of an electronic record of the information in a contract or other interstate or foreign transaction: 1) accurately reflect the information set forth in the contract; and 2) remain accessible to those entitled to access in a form capable of being accurately reproduced either by "transmission, printing or otherwise." Section 101(d)(1). Indeed, the Act does not prohibit States from enacting new electronic records or electronic signature laws, as long as those provisions reference E-SIGN and are in conformity with its requirements.

E-SIGN provides States a brief period of relief from the general October 1, 2000, effective date with regards to records retention provisions. E-SIGN's preemptive effect on existing State (and Federal) records retention provisions is delayed until March 1, 2001. Section 107(b)(1)(A). Additionally, if by March 1, 2001, a State or Federal agency has "announced, proposed or initiated, but not completed" a rulemaking proceeding to prescribe a rule under E-SIGN with respect to retention of records, the Act becomes effective June 1, 2001, with respect to such rule. Section 107(b)(1)(B).

E-SIGN permits State and Federal agencies to use their existing rulemaking authority to promulgate regulations interpreting the Act. *See* Section (104)(b). Under such authority, State agencies may specify performance standards to assure the accuracy and integrity of electronic records and to assure accessibility to the records. However, the regulatory interpretations must: 1) be consistent with and not add additional requirements to those existing under the Act; 2) impose substantially equivalent requirements for electronic records as compared with paper records and 3) not impose unreasonable costs for the acceptance or use of electronic records. Such interpretations also must not afford greater legal status to the use of specific technology or software, thus, a State may not require the use of certain encryption software, for example. *See* Section 104(a)(2).

E-SIGN does not appear to preempt "writing" requirements for contracts to which the State is a party. *See* Section 101(b)(2). The Act would not seem to apply to totally *intrastate* commercial transactions—the language refers to transactions that are "in or affecting interstate or foreign commerce." *See* Section 101(a). Presumably, then, State tax agencies could require paper records for intrastate transactions that did not affect interstate or foreign commerce, although it may not be practical to enforce different requirements for records based on the interstate or intrastate nature of a transaction. Additionally, it appears E-SIGN would not require States to accept electronic versions of internal company records, like internal accounting records, for example.

UETA—What have States done so far?

At least 22 States have adopted a version of the Uniform Electronic Transactions Act ("UETA"), a model provision approved in 1999 as a recommendation to the States by the National Conference of Commissioners for Uniform State Laws ("NCCUSL"). The purpose of the UETA is to remove barriers to electronic commerce by validating and effectuating electronic records and signatures. Arizona, California, Delaware, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine Maryland, Minnesota, Nebraska, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Utah and Virginia have adopted UETA in full or substantial form. Another seven States (Alabama, Colorado, District of Columbia, Michigan, New Jersey, Vermont, West Virginia) have introduced bills to enact UETA. (*See* UETA Online at www.uetaonline.com for information on States' adoption of the model provision.) Congress passed the E-SIGN law as an interim uniform measure to address use and acceptance of electronic signatures until all States have adopted UETA. There are some differences between UETA and E-SIGN related primarily to consumer protections. For State tax agencies, however, the impact of UETA on records retention laws essentially is the same as under E-SIGN. States that enacted UETA prior to adoption of E-SIGN (June 2000) still must ensure that any variations in their versions of UETA from NCCUSL's 1999 official UETA provisions do not deviate from the requirements under E-SIGN. As of February 2001, a copy of the UETA was available online at www.law.upenn.edu/bll/ulc/fnact99/1990s/ueta99.htm.

Section-by-Section Summary of Provisions of Electronic Signatures in Global and National Commerce Act (E-SIGN)

Title I—Electronic Records and Signatures in Commerce

Sec. 101. General Rule of Validity.
Section 101(a) sets forth the general rule that a transaction in or affecting interstate or foreign commerce may not be denied legal effect, validity or enforceability because an electronic record or electronic signature is used to effect that transaction.

Section 101(b) provides that this title preempts any law requiring that contracts or other records be in written, signed or nonelectronic form. It requires governmental agencies to accept electronic records utilized in private transactions. This provision, however, does not require private parties to utilize electronic records, nor does the provision appear to require governmental agencies to utilize electronic records in transactions to which such agencies may be a party.

Section 101(c) requires affirmative consumer consent to use of electronic records. The section requires clear disclosures to the consumer regarding withdrawing consent (and any associated fees), obtaining equivalent paper records (and any associated fees) and hardware and software requirements for use of electronic records and any revisions to such requirements. Existing consumer protection laws regarding content or timing of disclosures are preserved under this section. Oral communications are not considered electronic records.

Section 101(d) permits the retention of contracts or records in electronic form as long as the electronic record accurately reflects information in the record and is accessible to those entitled by law to access such information in a form capable of being accurately reproduced. A legal requirement that original records be retained may be met by retaining electronic records that comply with the retention requirements of this section.

Section 101(e) provides that the validity of an electronic record may be denied if the record is not in a form capable of being retained and accurately reproduced.

Section 101(f) clarifies that this title does not affect the proximity required under law with respect to warnings, notices or disclosures required to be posted, displayed or publicly affixed.

Section 101(g) permits electronic notarization and acknowledgement.
Section 101(h) upholds the validity of contracts entered into by electronic agents as long as the action of the electronic agent is legally attributable to the person to be bound.

Section 101(i) expresses the explicit intent of Congress that this title and title II apply to the business of insurance.

Section 101(j) permits an insurance agent acting under the direction of a party entering into a contract electronically to be held harmless for any deficiencies in electronic procedures except where the agent's actions were negligent, reckless or intentionally tortious or where the agent either developed the electronic procedures used or deviated from the electronic procedures agreed to by the parties.

Sec. 102. Exemption to Preemption
Section 102 (a) indicates that E-SIGN does not preempt State laws: 1) enacting the Uniform Electronic Transactions Act; 2) specifying procedures consistent with titles I and II of the Electronic Signatures in Global and National Commerce Act and do not afford greater legal status to specific technology or 3) laws specifically referencing this Act.

Section 102 (b) indicates that the prohibition against specifying technology to be used under Section 102(a) does not apply to laws governing procurement by any State, agency or instrumentality thereof.

Section 102(c) prohibits the State from circumventing Section 102(a) through imposing nonelectronic delivery methods under the Uniform Electronic Transactions Act.

Sec. 103. Specific Exceptions.
Section 103(a) provides that the provisions of Section 101 do not apply to transactions governed by State law concerning wills, codicils or testamentary trusts or adoption, divorce or other matters of family law or to the UCC, except for sections 1-107 and 1-206 and Articles 2 and 2A.

Section 103 (b) provides that the provisions of Section 101 do not apply to court orders and notices and other official court documents, nor does it apply to notices of termination of utility services, repossession or eviction or termination of health insurance.

Section 103(c) requires a three-year review and evaluation of exceptions to Section 101 by the Secretary of Commerce through the Assistant Secretary for Communications and Information.

Sec. 104. Applicability to Federal and State Governments.
Section 104(a) indicates that the title does not limit State regulatory agencies or Federal regulatory agencies (subject to Section 104(c)) or self-regulatory organizations from requiring records to be filed in specified standards or formats.

Section 104(b) permits Federal and State regulatory rulemaking authority with respect to interpreting Section 101 as long as such interpretations are consistent with Section 101 and does not add to requirements under that section. This section also permits regulatory agencies require interprets Section 101 to require paper records where there is a compelling governmental interest related to law enforcement or national security.

Section 104(c) prohibits reimposing paper record requirements except under the limited circumstances indicated in Section 104 (b). This section also clarifies that Federal regulatory agencies remain under the obligations set forth in the Government Paperwork Elimination Act.

Section 104(d) permits a Federal regulatory agency to exempt a specified category of records from the consent requirements under Section 101(c), only after notice and an opportunity for public comment is provided.

Sec. 105. Studies.
Section 105 (a) requires the Secretary of Commerce to conduct a study with one year of enactment of the Act regarding the effectiveness of delivery of electronic records via email in comparison to delivery of written records via U.S. mail.

Section 105(b) requires the Secretary of Commerce and the Federal Trade Commission to submit a report within 12 months of enactment regarding benefits to consumers of electronic consent procedures.

Sec. 106. Definitions.
Section 106 provides definitions for the following key terms under the Act: "consumer", "electronic", "electronic agent", "electronic record", "electronic signature", "federal regulatory agency", "information", "person", "record", "requirement", "self-regulatory organization", "state" and "transaction".

Sec. 107. Effective Date.
Section 107 establishes the effective date of the Act as October 1, 2000. However, the records retention require

ments of E-SIGN become effective March 1, 2001, or June 1, 2001, if a State of Federal agency have pending rulemaking proceedings as of March 1, 2001.

Title II—Transferable Records

Sec. 201. Transferable Records.
Section 201 provides that negotiable instruments secured by real property may be created and stored electronically. Under the Act, the electronic version of this kind of instrument is referred to as a "transferable record." A holder of a transferable record has the same rights and defenses a holder in due course under the UCC of a written equivalent of such record.

Sec. 202. Effective Date.
Section 202 sets the effective date of Title II as 90 days after the date of enactment of E-SIGN.

Title III—Promotion of International Electronic Commerce

Sec. 301. Principles Governing The Use of Electronic Signatures in International Transactions.
Section 301 requires the Secretary of Commerce, guided by enumerated principles, to promote the use and acceptance of electronic signatures on an international basis.

Title IV—Commission on Online Child Protection

Sec. 401. Authority to Accept Gifts.
Section 401 amends the Child Online Protection Act to authorize the Commission to accept gifts of services and real and personal property. •

ENDNOTES

[1]An exception to the Act's general effective date are the records retention provisions of the Act, which become effective March 1, 2001. See Section 107.
[2]*Report of the Senate Committee on Commerce, Science and Transportation on S. 761*, Report 106-131, July 30, 1999, page 2. The Senate Commerce Committee report states an additional purpose of E-SIGN: "This legislation also assures that a company will be able to rely on an electronic contract and that another party will not be able to escape their contractual obligations simply because the contract was entered into over the Internet or any other computer network." *Id.* at 2-3.
[3] "This Federal preemption of State law is designed to be an interim measure. It preempts State law until the State enacts uniform standards which are consistent with those contained in this legislation or the UETA." *Report of the Senate Committee on Commerce, Science and Transportation*, Report 106-131, July 30, 1999, page 3.
[4]*Report of the Senate Committee on Commerce, Science and Transportation*, Report 106-131, July 30, 1999, page 3.
[5] E-SIGN defines "electronic record" to mean "a contract or other record created, generated, sent, communicated, received, or stored by electronic means." Section 106 (4).
[6]Reporting as required under the Unfunded Mandates Reform Act, the Congressional Budget Office estimated that E-SIGN would not significantly affect the budgets of state, local, or tribal governments. *Report of the Senate Committee on Commerce, Science and Transportation, Report*, pages 3-4. State tax agencies, for one, may have to expend substantial resources reviewing existing laws for compliance with the Act, training personnel to adequately handle the electronic records they are likely to receive during an audit or in litigation, acquiring the hardware and software capable of reading electronic records or converting electronic records into readable format, *etc.*

Nexus Update

By H. Beau Baez III, Counsel, MTC

The following cases and rulings show that nexus continues to be a hot area in state and local taxation. One key development is the New York State Department of Taxation's ruling that an out-of-state computer company's use of an independent contractor to provide in-state warranty services creates sales and use tax nexus. New York's ruling is substantially the same as Nexus Bulletin 95-1. This bulletin was an educational effort by the Multistate Tax Commission that provided guidance to remote sellers of computers that their provision of in-state warranty services by unrelated third parties was sufficient to create a sales and use tax collection obligation for all of their sales into a state.

Kansas

In the Matter of the Appeal of Intercard, Inc., Docket No. 99-83802-AS (KS Supreme Court, December 8, 2000). The Kansas Supreme Court held that an out-of-state company that sent its employees into Kansas on eleven occasions was not required to collect the use tax. Intercard is in the business of selling copy card readers and supplies to Kinko's Copies. On eleven separate occasions Intercard sent an employee into Kansas to install card reading machines at various Kinko's Copies locations and also had extensive contacts with Kinko's Copies through sales via common carrier. The Court, without analysis, stated that these eleven visits were "isolated, sporadic, and insufficient to establish a substantial nexus to Kansas." *(Note: This case provides little guidance to taxpayers or the revenue department. At most a taxpayer knows that in some cases eleven visits by technicians does not create nexus. What about twenty, seventeen, or even twelve?)*

Massachusetts

Commissioner v. Jafra Cosmetics, SJC-08265 (Mass., Jan. 25, 2001). Massachusetts' high court has ruled that an out-of-state multi-tiered direct selling company must collect the sales and use tax. Jafra Cosmetics was a California corporation that sold its products to independent contractors (i.e., "consultants") who in turn marketed the products through the direct selling method. The in-state sellers were not allowed to sell these products to retail establishments but rather sold the products by holding classes in private homes. Consumers would purchase cosmetics from their consultants who in turn placed orders with the California company. The Court explained that these independent contractors were representatives of the California company and thus obligated the California company to collect the sales tax. Specifically, this Court adopted the reasoning of Scripto v. Carson, 362 U.S. 207 (1960) where the United States Supreme Court found that a representative could create nexus for an out-of-state company. *(Note: Representational nexus was approved by the United States Supreme Court in 1960, yet many companies continue to ignore state laws that expressly disapprove of form over substance planning techniques in the sales tax context, i.e., employee vs. independent contractor distinctions. However valuable such distinctions might be for other areas of the law these distinctions have little application to state sales and use taxes.)*

Syms Corp. v. Commissioner of Revenue, Nos. F215484 & F228324 (Mass. Appellate Tax Board, September 14, 2000). The Board rejected a taxpayer's royalties payment deductions because the transaction did not have any economic substance. Syms is a retail establishment with stores nationwide. In 1986 Syms decided to reduce its state income taxes by establishing a Delaware holding company that would hold its trademarks. Under this plan Syms "could choose how often to pay royalty fees" and then the holding company would "pay a dividend to Syms equal to the royalty payment plus interest once the money had remained in Delaware for a couple of weeks." The Board, in a lengthy opinion, found that the only purpose for this transaction was tax avoidance and thereby denied the royalty deductions. See also, *Sherwin-Williams Co. v. Commissioner*, No. F233560 (Mass. Appellate Tax Board, July 19, 2000). (*Note: This case is illustrative of how different states can look at the* *same facts and attempt to get to the same result using different approaches. The first approach is the denial of a royalty deduction to the in-state company and the second approach is to pursue a nexus claim against the out-of-state holding company (the Geoffrey approach). In SYL, Inc. v. Comptroller, No. C-96-0154-01 (Maryland Tax Court, April 26, 1999) the Maryland Comptroller chose the nexus/Geoffrey approach and lost its case with Syms. The Maryland Court ruled against the comptroller because it found that the out-of-state holding company did not have nexus in Maryland. Syms and SYL: Parent and subsidiary, two states, two approaches, and two different results.)*

NewYork

TSB-A-00(42)S (New York State Advisory Opinion, October 13, 2000). The New York State Department of Taxation and Finance has advised that an out-of-state computer company's use of independent contractors to repair equipment creates sales and use tax nexus. A mail-order computer company located outside of New York hires independent contractors to repair its customers' computers in New York. The Department explained that under New York law this is sufficient activity in New York to require the out-of-state company to collect and remit the New York sales and use tax. *(Note: Under the United States Supreme Court case Scripto v. Carson an out-of-state company can be required to collect the sales and use tax if it has a representative in the state. The relevant inquiry is not the title of the in-state person but rather the activity that is being performed. If the activity helps to maintain or create an in-state market that will be sufficient to create nexus with that state.)*

Virginia

P.D. 00-160 (Virginia Department of Taxation, August 28, 2000). Tax Commissioner Danny Payne has ruled that an out-of-state company involved in leasing employees is not protected by P.L. 86-272. The taxpayer is an out-of-state corporation that leases employees to pharmaceutical companies that in turn use the leased employees to solicit sales of tangible personal property. The Commissioner explained that the out-of-state company is in the business of furnishing services — provision of services exceeds the protections of P.L. 86-272. *(Note: Companies that outsource their sales force are protected by P.L. 86-272 as long as their independent contractors adhere to the restrictions of P.L 86-272. However, the companies that provide the salesmen are not protected because they are in the business of providing a service.)*

Wisconsin

Joan LaRock v. Wisconsin Department of Revenue, No. 99-0951 (WI Supreme Court, February 13, 2001). The Wisconsin Supreme Court has ruled that an Indian member of one tribe that worked on another tribe's reservation was subject to the Wisconsin income tax. LaRock was an enrolled member of the Menominee Tribe, but lived and worked on the Oneida Tribe reservation. LaRock claimed that as an "Indian" she was exempt from state taxation because she was living in "Indian country." The Wisconsin Supreme Court explained that exemption from state taxation was grounded in notions of tribal sovereignty and not generic "Indian" sovereignty. Clearly if LaRock had been earning income on her own reservation she would have been exempt from Wisconsin's income tax. The Court opined that tribal sovereignty does not extend outside of an individual reservation for state tax purposes, thus LaRock was subject to the state's net income tax. *(Note: Though this court has held that a member of an Indian tribe working on a different tribe's reservation allows the state to tax that tribal member, this is an issue that can be resolved by Congress. Congress has plenary authority over the Indian tribes and can pass legislation to regulate this area of state taxation).*

Current Uniformity Projects of the Multistate Tax Commission

(For a description of the uniformity process, please visit our website at www.mtc.gov/uniform/UNIproj.htm.)

Uniformity Proposals in the Public Hearing Process

Project	Status/Anticipated Completion Date of Hearing Officer Report	Earliest Possible Action by Commission
Proposed addition of definition of "gross receipts" to MTC Reg. IV.2.(a).	Final hearing officer's report submitted January 2001.	April 2001
Proposed Revision of MTC Guideline for Public Law 86-272	Hearing scheduled for March 15, 2001	July 2001
Uniformity Proposal Concerning Residence of Funeral Trusts	Hearing scheduled for March 19, 2001	July 2001
Uniform treatment in the property factor of outerjurisdictional property.	Hearing to be scheduled	Not yet established

Uniformity Proposals Under Development by the Uniformity Committee
Sales/Use Taxes

Project	Committee Completion Target	Earliest Committee Completion
Sales/Use Tax Priority	Not yet established	Not yet established
Taxation of Fund-Raising Transactions: development of database of state practices and procedures (Joint Project with Assn. of Fund Raisers and Direct Sellers)	March 2001	March 2001

Income/Franchise Taxes

Project	Committee Completion Target	Earliest Committee Completion
Definitions of Unitary Business	Report of PPWG-Uniformity Committee Liaison Group submitted March 1999. Uniformity Committee review and completion of draft proposed definitions in progress.	Not yet established
Corporate Income Tax Administrative Uniformity (Joint Project with the AICPA)	Not yet established	Not yet established
Uniformity in state tax administration of pass-through entities	Not yet established	Not yet established

Membership Opportunities for the States in the Multistate Tax Commission

The Multistate Tax Commission was established in 1967 for the purposes of:

- Preserving the States' tax sovereignty.
- Facilitating the proper determination of the state and local tax liability of multistate tax payers.
- Promoting uniformity and compatibility in tax systems.
- Facilitating taxpayer convenience and com pliance.
- Avoiding duplicative taxation.

Forty-five States, including the District of Columbia, participate in the Commission.

The Commission speaks with a strong voice to Congress and the courts on the need to preserve the legitimate tax authority of the States from unwarranted federal intrusion.

The Commission recommends uniform tax policies and practices to improve the efficiency and fairness of state tax systems for both taxpayers and the States.

The Commission supports proper tax compliance and cuts administrative costs through its Joint Audit and National Nexus Programs.

Compact Membership

Compact Members are States that enact the Multistate Tax Compact and govern the Commission's activities pursuant to the Compact's expressed purposes. Compact Members provide leadership in fostering interstate cooperation on challenging multistate tax issues. They direct the Commission's uniformity, federal relations, educational and litigation support activities. Compact Members share general Commission costs through a formula specified in the Compact.

Sovereignty Membership

Sovereignty Membership is a new opportunity for States to benefit from participation in the Commission!

Sovereignty Members join in shaping and supporting the Commission's efforts to preserve state taxing authority and improve multistate tax policy and administration. They participate in the Commission's uniformity, federal relations, educational and litigation support activities. Costs conform to the formula in the Compact. Benefits are similar to Compact Membership, but do not require enactment of the Compact.

Project Membership

Project Members are those States that participate in and support specific Commission projects or programs, but are not otherwise members of the Commission. The Commission currently has four projects that States can join:

- Joint Audit Program
- National Nexus Program
- Property Tax Fairness Project
- Property Tax Audit Program

Costs and terms of participation are unique to each program.

Associate Membership

Associate Members are States that wish to participate in Commission meetings with an eye to considering broader participation in Commission activities. Several Associate Members have become members of particular Commission programs or projects or have become Compact Members. There is no cost for Associate Membership.

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CALENDAR OF EVENTS

May 2-4, 2001	Spring Executive Committee Meeting The St. Anthony Hotel, San Antonio, Texas
July 22-27, 2001	34th Annual Meeting & Committee Meetings Radisson Inn, Bismarck, North Dakota
October 28 - November 2, 2001	Fall Program and Executive Committee Meetings The Business-Government Dialogue on State Tax Uniformity *Dates and Hotel to be Announced*
July 28-August 2, 2002	35th Annual Meeting & Committee Meetings Monona Terrace Convention Center & Hilton Madison Monana Terrace, Madison, Wisconsin

Please contact Teresa Nelson, Production Editor, at 202-624-8699 to request a more detailed Calendar of Events that includes hotel and meeting registration information and tentative committee meeting schedules.

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