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VIRGINIA SALES TAX—TECHNICAL ISSUES AND EXPERIENCES

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It is indeed an honor to be a part of this Tax Conference and to discuss with you some of the technical issues and experiences in the administration of the Virginia Retail Sales and Use Tax Act. In addition, it gives me the privilege of participating in a conference with tax specialists, who play an all important role in any tax program.

The annual income to be derived by the Commonwealth of Virginia and its political subdivisions from the 3% State Sales and Use Tax and the 1% local Sales and Use Tax is estimated at \$240.4 million for the fiscal year 1968-69. This compares to \$240.2 million in Individual Income and Fiduciary taxes and \$51 million in Corporate Income Taxes for the same fiscal year. Therefore, you can see that Sales and Use Taxes are an important source of revenue and contribute a proportionate share to the budget of the Commonwealth of Virginia and its political subdivisions.

The modern State Sales and Use Tax came into being in 1932 and by 1937 there were 21 states which had adopted general sales and use taxes at the rate of 2% or 3% on retail sales. By 1965, Virginia was one of only eleven states which had not adopted a general sales and use tax, however, on March 12, 1966, Virginia, as you know, enacted into law the present act, imposing a State sales and use tax of 2%, to be increased to 3% July 1, 1968, and granted to the political subdivisions the authority to impose a 1% local sales tax. (A subsequent amendment to the act by the 1968 Session of the General Assembly authorized political subdivisions to impose a 1% local use tax.)

The sales and use tax yield is determined largely by the base of the tax and a major factor in arriving at the tax base is the number of exemptions permitted; the smaller the exemptions the higher the base. Not only does a limited number of exemptions increase the base, but it decreases the cost of administration. Section 58-441.6 of the Code of Virginia sets forth the exemptions under the act and each exemption carries with it an administrative problem of construction and interpretation.

The disposition of the sales and use tax revenue is made in the following manner:

1. All State Tax money collected is paid into the general fund of the State Treasurer.
2. Prior to July 1, 1968, one-half of this money in the general fund was distributed to the counties and cities, based on school age population. Now, as a result of the increase in the State rate from 2% to 3%, effective July 1, 1968, one-third of the State money is distributed to the counties and cities based on school age population.
3. In addition, every county or city may impose a 1% local sales tax and after July 1, 1968, a 1% local use tax. These collections are remitted to the Department of Taxation where they are deposited to a special account and returned to the counties and cities imposing the tax.
4. Therefore, one-half of the revenues collected from combined State and local tax is used for local purposes and no charge is made to the locality for the collection of the local tax. All distributions to localities are made monthly.

Since each of you is a tax accountant or tax attorney, I will not endeavor to review the Sales and Use Tax Act or the Rules and Regulations, but I would like to take this opportunity to discuss certain barriers that confront the Sales Tax Administrator.

Interstate Commerce

When one considers a state sales and use tax he instinctively, but erroneously, believes he is considering a local problem. This is far from the truth since many transactions involve dealings among the various states, and a great deal of interaction among the different states. These transactions, of course, involve interstate commerce, and as you may know, the Federal Constitution states that "Congress shall have the power . . . to regulate commerce with foreign nations, and among the several states . . .". Therefore, no state can impose a sales or use tax which places an undue burden on interstate commerce, but what constitutes an undue burden is a question of fact which must be resolved by examining the circumstances of each particular case.

Suppose a vendor purchases merchandise outside his state of residence and returns home with his purchase? It is apparent that states imposing a sales tax would lose to foreign states many retail transactions by their residents if purchases (sales) made in states not imposing

sales taxes could not be taxed by states in which the property was used. States, in order to prevent the loss of revenue and customers to their retail merchants, began imposing a use tax. The use tax may be levied on (1) the purchaser for the privilege of using the goods within the state or (2) the vendor for the privilege of marketing his goods within the state. The imposition of this tax has been held constitutional and the right of a state to impose a use tax on the use of property within its jurisdiction has been well established.

In upholding the use tax, the courts have observed that the use tax does not discriminate against interstate commerce, but instead achieves equality between purchases made within and without the state. The imposition of a use tax has destroyed a major advantage enjoyed by non-sales tax states.

Suppose that the state in which the vendor resides imposes a sales tax on a transaction which involves interstate commerce, and the state of destination imposes a use tax on the same transaction. Obviously, this would create an undue burden and would be unconstitutional. Case decisions have resolved this dual taxation problem, by forbidding the vendor's state from imposing a sales tax on this interstate transaction.

In essence, what has been said up to this point is that when two states are involved in an interstate transaction, only the state of destination may impose a tax on it.

In the above, I have attempted to show which state may levy a tax on an interstate transaction; the following considers the question of who may be required to collect the tax. First, let us dispose of the problem of collecting the sales tax.

The state of destination can obviously require an out-of-state vendor to collect a sales tax on sales made within the state by out-of-state vendors. However, the state of destination cannot require the out-of-state vendor to collect a sales tax on sales made without the state, even if the out-of-state vendor delivers property within the state in his own vehicle. Hence, unless a sale is made within the state, no sales tax may be levied by the state of market on the transaction, however, such an interstate transaction is subject to the use tax.

This leads us to the difficult problem of determining which out-of-state vendors may be required to collect the use tax. The Supreme Court has held that the use tax is not an undue burden on interstate commerce; therefore, the out-of-state vendors have been reduced to the single argument that the state of destination cannot require them to collect a use tax because the state has no jurisdiction over them.

The test then is—Has an out-of-state vendor brought himself under the state's jurisdiction by establishing sufficient contact within the state which will bring him within the jurisdiction of the state of market?

The general rule is that the out-of-state vendor is required to collect

the use tax. There are, as of this date to my knowledge, only two Supreme Court cases where the out-of-state vendor was relieved from collection of the use tax. The first case involved a Delaware vendor, advertising in Delaware and making sales in Maryland as a result of this advertising. Deliveries were made into Maryland by the Delaware vendor. The court held that the Delaware vendor could not be required to collect the Maryland use tax because he was not exploiting the market by actively promoting sales and because his deliveries were occasional rather than regular and systematic.¹

The second Supreme Court case involved sales made solely by mail order. In this case, the inducement to purchase was made solely through the mail with no local activities or advertising within Illinois, however the case was not decided on a contact basis, but rather that this was a pure interstate commerce business and as such no tax could be placed on it.²

The two cases just referred to, represent the exception to the general rule requiring vendors to collect the use tax.

It was held in *Scripto Inc. v. Carson*,³ that a foreign vendor had sufficient contacts with the state of market simply by making sales within the state through independent contractors. Apparently, no line has been drawn determining what activities are sufficient to make a vendor a use tax collector for a state in which he markets his products, yet many feel that the mere exploitation of a state's market is sufficient activity by a vendor to bring him within the jurisdiction of that state's laws. Unless an out-of-state vendor engages in precisely the activities specified in *Miller Brothers* or *National Bellas Hess*, he will be required to collect use taxes within the state of market.

The collection of use taxes is, as I have shown, a national problem under present case law; loop holes have developed which exclude certain vendors from collecting the use tax and make collections of the tax highly unlikely. Of course, the state may levy the tax on the in-state consumer, however, the impracticability of this is self-evident and needs no development. The situation now is one where some vendors are taking advantage of "legal loop holes" to the detriment of other vendors, especially the local vendor, as his product will be taxed, and the "legal loop hole vendors" product will not be taxed.

¹Miller Brothers Company v. Maryland, 347 U. S. 340 (1954).

²National Bellas Hess, Inc. v. Department of Revenue, 386 U. S. 765 (1967).

³Scripto Incorporated v. Carson, 362 U. S. 207 (1960).

National Banks

On June 17, 1968, a divided United States Supreme Court held that a federal statute of long standing (12 USC 548) bars the imposition of state and local sales and use taxes on purchases of tangible personal property by National Banks.⁴

On its face, this ruling applies to those state and local sales tax laws which require the tax to be collected from the purchaser. Nominally, at least, the distinctions between such a sales tax and one legally imposed on the vendor is still recognized, however, the action of the Supreme Court in rejecting the Massachusetts sales tax as one imposed on the vendor, suggests the possibility that the sales tax laws of other states which contain qualified pass-on provisions might also be construed to be vendee-type rather than vendor-type sales taxes.

Naturally the decision will have an effect on state and local sales and use tax revenues and we estimate that the loss of revenue in Virginia as a result of this case, will be approximately \$1.5 million per year. We might say the court had no other choice than to exempt National Banks in view of the Congressional Act imposed in 1864.

As a result of this decision, the State Tax Commissioner of Virginia was required to hold on July 18, 1968, that National Banks and State Banks in Virginia are exempt from Virginia sales and use taxes on purchases and leases of tangible personal property for their own use. (State banks were included in the exemption pursuant to Section 58-441.46 of the Code of Virginia.)

It is clear that any change in the law governing the taxation of National Banks by the states will have to come from Congress and that the initiative for such a change will have to come from the states.

Shortly after this decision of the Supreme Court of the United States, Congressman Podell of New York introduced in the House of Representatives HR 19031, a bill to clarify the liability of National Banks for sales and use taxes. The bill briefly stated that a National Bank has no immunity from any sales or use tax which it would be required to pay if it were a bank chartered under the laws of the state or other jurisdiction in which its principal office is located.

This bill was not acted upon by the 90th Congress, but we can be assured that legislation of some form will be introduced by the states when the 91st Congress convenes in January, 1969. Both the majority and the minority opinion in the First Agricultural National Bank case supplied the ammunition which shows that such legislation should be passed.

⁴First Agricultural National Bank of Berkshire County v. State Tax Commission, 390 U. S. 1020 (1968).

Soldiers' and Sailors' Civil Relief Act

The United States Circuit Court of Appeals for the 2nd. Circuit held on July 10, 1968, in *U. S. and Schuman v. Sullivan* that the soldiers' and sailors' Civil Relief Act prohibited the imposition of the Connecticut sales and use taxes on purchases of tangible personal property by non-resident servicemen present in the state solely under military orders. Connecticut has appealed the case to the Supreme Court of the United States.

If the Supreme Court affirms this decision, an additional situation will be created in which persons will benefit from local government functions and not bear their fair share of the burden. Of more concern to the State Tax Administrators is the radical departure of the court in its interpretation of the statute and the administrative problems that would be encountered.

When we read the Soldiers' and Sailors' Civil Relief Act we find that for taxation purposes, the states in which military personnel are located cannot deem such personnel to be domiciled within the state or residents of the state, and that states cannot treat the personal property of such personnel as having a situs there. This prohibits no state from imposing a tax, it merely states that an income tax may be imposed only by the state of domicile or residency and a personal property tax may be imposed only by the state of situs of the property.

If the above statements were presented to a tax specialist, and that specialist were asked, "What type taxes would be affected by this law?"—he would not answer sales taxes. For neither the situs of personal property nor the purchasers domicile or residency have any bearing on the imposition of a sales tax. The language of the Act is taxation language and clearly not sales tax language.

Even if one wanted to prevent the state of purchase from imposing a sales tax he could not do so under the language of this Act. The Act only has a bearing on "taxation in respect—his personal property." This language cannot stop the imposition of a sales tax as the property protected is only his personal property and the property does not become his until after the purchaser has paid the sales tax or becomes obligated to do so, and therefore, the Act comes too late.

Should the Supreme Court sustain the lower court decision the problem among vendors as to who to charge and who not to charge would be fantastic; servicemen would legally be required to fill out and return a consumers use tax return to their home state on every purchase made by them outside their home state and a great deal of ill-will would arise between civilians and military personnel.

Washington National Airport

One other area of inequity in tax treatment is the Washington National Airport, which is in Virginia, yet no sales or use taxes can be imposed there. The land upon which the terminal is built was formerly in Arlington, Virginia, however, in 1946, this land was ceded to the Federal Government when Congress established Virginia's boundary line. Virginia voluntarily ceded this land, while reserving only the right to tax fuel to be used in the over-the-road vehicles.

At that time, Virginia realized it was giving up land and foregoing the tax revenues which that land would produce, but also it was sympathetic to a struggling airline industry and did not insist on the normal tax powers that the State would have in connection with independent businesses being conducted at a Federal installation or a Federal reservation.

The situation has changed greatly in the last 22 years, yet Washington National Airport is the only Federal Reservation in the country where independent businesses remain free of any taxes. Incidentally, Dulles, a Federal reservation recently constructed, has no tax immunity. There is no need to elaborate on the obvious tax discrimination against other vendors in Virginia and against the Washington metropolitan area as a result of this tax-free oasis.

Senator Byrd and Senator Spong introduced a bill in the 90th Congress to permit Virginia to impose income, fuel and sales taxes on the independent businesses located at the Washington National Airport. Such legislation would not only provide approximately \$2.5 million in State and local sales and use taxes, due Virginia, but also, it would eliminate the unjust discrimination against surrounding vendors.

As with all legislation, there was opposition to the bill. The airlines operating out of the Washington National Airport were opposed to the legislation and strong opposition was voiced by the Federal Aviation Administration. I might add that the Federal Aviation Administrator had a difficult time explaining why Washington National should be tax-free and its competitor, Dulles International, subject to all Virginia taxes.

Interstate Taxation Act

On May 23rd of this year, the House of Representatives passed the Willis Bill (HR 2158) by a vote of 384 to 89 and the bill was referred to the Senate Committee on Finance. The bill was reported by the House Judiciary Committee in March, 1967, and was cleared for floor action in July, 1967, but because of determined opposition, primarily from states, the bill was not scheduled for debate until May, 1968.

H. R. 2158 is the product of a multi-year investigation by a special

subcommittee of the House Judiciary Committee, headed by Representative Willis of Louisiana. The initial bill, introduced in October, 1965, was broader in scope, but because of heavy opposition, the subcommittee removed provisions relating to federal performance of administrative and judicial functions. What remained was primarily a measure to limit the jurisdiction of the states to tax.

The Council of State Governments, the National Governors' Conference and most other organizations of state officials have repeatedly expressed opposition to the Willis bill.

To give you some idea of the damaging effects of this bill as far as sales and use taxes are concerned, if ever enacted into law by Congress, H. R. 2158 would exempt certain multi-state business firms from state and local taxation in many of the jurisdictions where they would operate, and would reduce materially the state and local tax liabilities of many other firms. This would be done by establishing narrower jurisdictional standards for state and local taxation than those now permitted. In order to require that a seller collect a sales or use tax, the state or local government would have to find either physical property or at least one full-time employee within its territory. In the case of inventories, only that property which was actually in the name of the taxpayer would be counted. Under such rules, a variety of legal devices could be utilized to insulate a multi-state business from taxation.

Advertised as a bill to relieve small taxpayers, the bill contains a variety of provisions to prohibit a state or local government from engaging in certain practices relating to sales and use taxes, taxation of household goods and out-of-state audit charges which virtually all states already have abolished. The bill takes no account of changes in taxing practices made since the Willis subcommittee completed its study more than three years ago.

Title One, declares that a seller must have a "business location" in a state or political subdivision in order for the jurisdiction to have power to require that a sales or use tax be collected. A business location exists when a person owns or leases real property or has at least one employee or regularly maintains a stock of tangible personal property in the state for sale in the ordinary course of its business.

These provisions open the door to devices enabling the seller to avoid being taxed or required to collect sales and use taxes, such as using brokers or independent contractors as salesmen; shifting employees from jurisdiction to jurisdiction; accepting orders out-of-state; warehousing goods not in one's name and dealing through independent corporations.

Title Three, specifies that a sales tax may be imposed or a seller be required to collect a sales tax by a state only if the destination of the

sale is in the state or the seller regularly makes household deliveries in the state. It has been claimed that this is an extension of state jurisdiction, but states have this jurisdiction already.

Another provision would relieve a seller from collecting a sales tax if the purchaser furnishes a registration number of the state. This would make it necessary for the state to collect the tax from the buyer resulting in a tremendous decrease in sales tax collections.

The basic fault of H. R. 2158 is that it would deny state and local governments essential control over their own revenue-raising capacities. These governments are already hard pressed to meet the ever-increasing cost of providing necessary state and local services.

Proponents of the legislation have claimed that state and local tax systems are complex, incapable of collecting more than a minimum of the tax liability claimed, and burdensome for the taxpayers who must comply with them. But this legislation would not appear to meet these problems. It would give preferential relief to some taxpayers by exempting them from taxation or by limiting their tax liability. In so doing, it would shift the burden to others. Local retailers, owners of residential and farm properties, businesses with large, immovable assets in a particular community, even individual non-property taxpayers would probably receive larger state and local tax bills to make up for the losses.

Because Congress adjourned, no action was taken by the Senate Finance Committee but prior to adjournment, Senator Ribicoff of Connecticut stated to the Senate on October 14th, that it is regrettable that the 90th Congress was adjourning without final action on legislation to provide some uniformity in application of scores of state and local tax laws affecting interstate commerce business.

Senator Ribicoff went on to say that he was making available a new draft of the bill to include two additional amendments for consideration before the 91st Congress convenes in January. He urged the Committee on Finance to schedule consideration of this important legislation as early as possible in 1969 as a priority matter. Needless to say, the bill has the support of many major national associations, but I must say that we believe such legislation would be detrimental to the states, provide a real loss of revenue, penalize the in-state dealer by placing him at an unfair competitive disadvantage and create areas of doubt in sales in interstate commerce.

In conclusion, I must submit that there are many grey areas in sales and use taxation that we have to resolve in the years to come, but nowhere do we find greater problems than those which I have mentioned being created by court decisions and adverse legislation.

May I thank you for your attention and for letting me be with you this afternoon.

