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Friends, Students, Taxpayers, Lend Me Your Ears! Pay Your Use Tax!

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“Use tax” you say! Is it not enough to pay sales tax, that States and cities wants us to pay taxes for using something as well? Well, it would be seem unjustified to spring a new tax upon us but here is the surprising news! The use tax is not a new tax. It has existed in states almost as long as the sales tax. In fact, in many states, including California, the use tax has been established since the 1930’s!

The sales and use tax accounts for a significant portion of any state’s total tax revenue. The chart below shows the aggregate tax revenue for all states from different sources for the year 2009. The general sales and gross receipts tax is second only to the individual income tax in funding state government operations.

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item. The use tax is reported by the taxpayer on his/her state income tax return and is usually calculated using the state’s sales tax rate on items for which the retailers did not collect any sales tax. That means you are bound to be hunting for those receipts from your cruise in Alaska or from the Amazon Christmas shopping spree, come tax filing season.

To understand why we are subjected to this seemingly painful reporting task, let’s take a step back into the period of the Great Depression. The year is 1930. The American economy is in shock, and the government is in frenzy. State and local governments are hit hard with soaring unemployment, and more public assistance services were needed for which they did not have the ability to meet financially or institutionally. From these economic ashes rises one of the major revenue reforms of that period - The adoption of the sales tax. Mississippi was the first to adopt the sales tax in 1930 and by 1940 most of the other states followed suit.

Twenty-four states had decided to enact state level sales taxes in that period to boost state revenues, but because each state had a different rate, there was concern that states with lower or no sales tax might become tax havens for taxpayers when they shop in such states. To prevent the taxpayer shopping sprees in tax haven states, the use tax was adopted as a complement to the sales tax. The law on the use tax requires us to pay taxes on taxable goods and services that we purchase, but were not charged sales tax.

Now your next thought must be “Isn’t it bad enough that we have our hands full with remembering to pay our federal and state income taxes, and now we have to deal with figuring out another tax?”

Well, the reason paying the use tax becomes our responsibility is that some Internet and catalog retailers that we purchase from, such as Amazon.com, are not required to collect the sales tax in every state. They are exempt from sales tax collection if they do not have any physical presence within the state, which means that the state has no jurisdiction over them for this tax. This rule came about from a Supreme Court decision in 1992 called the Quill decision. States do give retailers the option to register with them to collect sales and use tax, but generally, sellers are not inclined to voluntarily collect it due to the associated costs and the possible alienation of customers. Therefore, as buyers, we need to report and pay the use tax when sellers are not required to and are not voluntarily collecting the sales tax from us.

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Now imagine if everybody in California, for instance, decided to do their shopping on Amazon.com or with any other company without a physical presence in the state. Students who don’t want to pay or cannot afford the exorbitant prices of their campus bookstore already worship online bookstores. And, is such online stores have no warehouses, offices or employees in California, they are not required to collect California sales tax. If the residents were not required to pay the use tax, California would lose about 88% of its $53 billion that is collected by the Board of Equalization through its tax and fees program. What would happen to all the services that are supported by this revenue?

The California Board of Equalization which is responsible for the collection of the sales and use tax, among other taxes, posts a list of the top sales and use tax delinquent accounts. For the third quarter of 2010, $333 million dollars was due for collection, and this amount only refers to the 250 accounts that owe more than $100,000. Include the rest of the 39 million state residents, and the Board estimates a loss of $1.145 billion in sales and use tax every year.

California is just one example of the 45 states, where not all of the sales and use tax owed is collected. Losing this much hurts state budgets and finding ways to collect the money is equally painful and is viewed by many as a waste of tax dollars. The states have to make up for the lost revenue and their only choices are to either reduce services or increase the rates of other taxes. The state of New York has already passed legislation that requires large vendors who are not physically present in the state to collect sales tax from customers who were referred to them by affiliates who operate in that state. The way this New York law works is that online retailers who, for example, pay commissions to website owners for posting links to their merchandise, are presumed to have sales and use tax collection obligations unless then can show that the affiliates with the weblinks are not soliciting sales for them. Amazon is now collecting tax under protest on shipments made to New York. North Carolina, Rhode Island and Illinois have passed similar laws, while other states have considered enacting similar proposals.

So does it mean that the states are winning and we are off the hook from keeping track of our use tax obligations? Not really. Some vendors subject to the new laws in New York, Rhode Island, North Caroline and Illinois have canceled their contracts with the in-state associates (website owners) to no longer be subject to the expanded sales tax collection obligations. Both Amazon and Overstock canceled contracts with their affiliates in states where the law has been implemented (other than Amazon in New York). In California, a letter by Amazon to the

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governor stated that forcing collections of tax in the state would cause Amazon to sever advertising ties with California based affiliates, which could cost Californians jobs.\textsuperscript{10}

Now we all may be thinking that our $100 purchases from out-of state retailers may not contribute much to the state’s tax revenue, but they all add up. Also, should keep in mind that not paying the use tax is considered tax evasion.

Also, since the states are threatening to force out-of-state retailers to collect the tax, and the retailers are counter-threatening to cut ties with their in-state affiliates, eventually it is we, the taxpayers who are going to suffer. The loss of revenue generated from such transactions will hurt the state economy and will probably result in more budget cuts.

While any change of heart to pay all our use tax will not affect the outcome of the stalemate between the states and vendors, we will be fulfilling our responsibility to pay our taxes which we have to in any case ("It's the Law"). Also, payment of our use tax may prevent legislators from increasing other taxes.

Payment of the use tax is fairly simple. Almost all states have a line on the state income tax form to report use tax. All you have to do is keep track of your purchases from vendors who did not charge you sales tax, but from whom you purchased a taxable item. There are no complicated calculations, and the use tax rate is the same as the sales tax rate. In California, Governor Jerry Brown recently signed Senate Bill 86 that will allow taxpayers to refer to a Use Tax Table for purchases less than $1,000 and pay an estimated tax based on adjusted gross income instead of the actual amount of use tax due to the retailer. This seems like a good approach for people who dislike filling their pockets and purses with shopping receipts.

You can find more information on how to report and pay your taxes on your state’s department of revenue website. In California, the Board of Equalization’s resource center http://www.boe.ca.gov/sutax/sutprograms.htm gives detailed information regarding the sales and use tax.

So, the next time when you shop on Amazon, you will know that there is a tax to be paid, why it exists and how to pay it.