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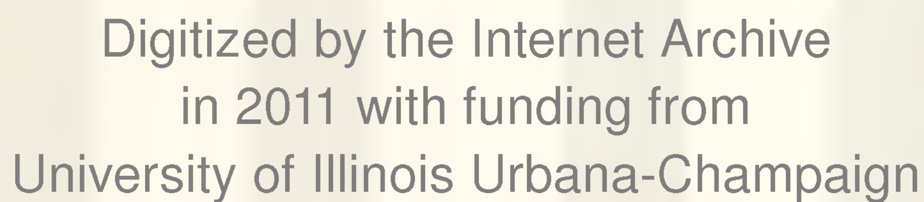
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STATE SALES TAX STRUCTURE AND OPERATION IN THE LAST DECADE - A SAMPLE STUDY

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#627

College of Commerce and Business Administration
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Summary:

No new state sales tax has been introduced since 1969. The trend has been toward increased exemptions and a limited increase in rates.

There is no significant evidence that the administration of the sales taxes has improved materially. The trend toward third generation computers with on line direct access has continued slowly. Improved timing of deliquency control has not lessened the percentage of delinquents. Audit coverage has on the whole not improved and is less complete in some states than a decade ago. Trend continues toward functionalization of revenue departments and integration of sales and income tax audit.

STATE SALES TAX STRUCTURE AND OPERATION IN THE LAST DECADE--A SAMPLE STUDY

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The number of states using the sales tax has remained unchanged since Vermont imposed the tax in 1969. But changes, not drastic but not insignificant, have been occurring in the taxes over the decade of the seventies. The broad picture of structural changes was surveyed in a recent article in the Canadian Tax Journal.[1] The purpose of this article is to survey in depth the changes that have occurred in the structure of the taxes, and current administration and operation of them in a sample of 13 states--Hawaii, Arizona, New Mexico, Nevada, Utah, Georgia, Kentucky, Virginia, Illinois, Indiana, Michigan, Rhode Island, and Massachusetts.[2]

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[1] John F. Due, "Changes in State, Provincial, and Local Sales Taxation in the Last Decade," Canadian Tax Journal, Vol. 27 (Jan. Feb. 1979), pp. 36-45.

[2] The sample was chosen to provide a broad geographical coverage, including both large industrial and smaller less industrial states, subject to the constraint of the need to minimize travel expenses. The authors are indebted to the officials of the revenue departments of the 13 states for their assistance.

I. CHANGES IN STRUCTURE AND RATES OF THE TAXES

The sales taxes in the sample states have not undergone drastic change, but the changes have been in the direction of broadening exemptions, with minor exceptions (Nevada brought periodicals under the scope of the tax). The states have not been hard pressed for revenue, and thus the pressure against revenue loss from additional exemptions has weakened.

Food. Four of the 13 states have added a food exemption since 1970 (two others already had it): Kentucky, Michigan, Indiana (replacing the income tax credit) and Nevada, as of 1979. The exemption in Nevada will be eliminated if Proposition 6 rolling back the property tax passes. Seven of the states continue to tax food. The Illinois legislature provided for food exemption in 1979 but the Governor vetoed the measure. The pressure to exempt food has been strong in Utah and other states.

Despite recommendations of the governor for a food deduction (exemption), the 1979 New Mexico legislature enacted a credit against individual income tax reflecting gross receipts (sales) tax paid on food, to the extent of $40 per year per exemption. This is of course very liberal, and has the effect of making the tax progressive at the lower income levels. This accompanies a $5 credit for tax on medical services and medicines, and a general low income credit designed to relieve individuals and families with below poverty-level incomes of excessive state and local tax burdens. The low-income comprehensive tax credit intends to prevent these income groups from paying a greater proportion of their income in taxes than do families of the same size with incomes at the poverty level. Together these measures constitute a negative income tax, to a greater extent than in any other state.

Hawaii continues its income tax credit for tax on food and medicine (though not so labeled), and Indiana has introduced a very liberal ($25) credit for sales tax paid on domestic utility service by the elderly.

Medicines and drugs. Arizona, Nevada, Kentucky, Utah, Michigan, and Virginia exempted drugs and medicines in the period; in addition to the two states having an income tax credit, only Georgia and Illinois still tax prescription drugs (and the latter on the ingredient cost, not the charge to the customer).

Other consumer goods. Kentucky and Rhode Island exempted domestic fuel and electricity, and Utah lowered the rate to 1% on these items. Rhode Island added a clothing exemption. Arizona eliminated residental rentals from the tax.

Producers goods. The trend has also been to broaden the exclusion of producers goods although Michigan did tighten its exemption somewhat. Two states phased in an exemption of industrial machinery and equipment used directly in the production process: Rhode Island, beginning in 1974, and Illinois, beginning in 1979. The latter is somewhat more restrictive than in other states, the extractive industries not being covered. Georgia exempted farm machinery and Utah is phasing in this exemption. The category most frequently added to the exemption list has been pollution control equipment, in Kentucky, Michigan, and Virginia, and solar energy equipment in several.

Unlike the 'sixties, there has been no tendency to add services in the 'seventies. Hawaii and New Mexico alone tax most services.

Rates. There have been relatively few changes in rates:

State	State Rate		Maximum State and Local Rate	
	1971	Aug. 1, 1979	1971	1979
Hawaii	4	4	4	4
Arizona	3	4	5	6
New Mexico	4	3.75[1]	4	4.75
Nevada	3	3	3.5	3.5
Utah	4	4	4.5	5
Kentucky	5	5	5	5
Georgia	3	3	3	5
Virginia	3	3	4	4
Indiana	2	4	4	4
Illinois	4	4	5	5
Michigan	4	4	4	4
Rhode Island	5	6	5	6
Massachusetts	3	5	3	5

[1]Effective 7/1/78.

Thus the state rates have gone up in 4 states (in 3 by only 1 percentage point) and down in one (to accomodate a rise in the local rate). The combined state and local rate maximum is 6. There are now one 3.5%, four 4%, one 4.75%, five 5%, and 2 6% rates in the sample. Seven of the combined rates remained the same; none fell.

II. THE NUMBER OF VENDORS AND THE ANNUAL TURNOVER OF ACCOUNTS

Table I shows the number of active vendors registered under the sales tax and related levies, the change since 1970, and, where available, the annual turnover of accounts. The number of accounts had grown substantially over the last decade in the four continental western states and substantially--but a small amount per year--in Hawaii, Georgia, and Rhode Island. Only Illinois shows a drop, and this may reflect some revision in the definition

Table I

Number of Registered Vendors Under Retail Sales Taxes, Sample States

State	Number of Registered Vendors 1970	1978-79	Percent Change, 1970-1979	Accounts Per 100,000 Population	New, 1978	Cancelled 1978	Turnover of Accounts: New as Percent of Total	Can[illegible] as [illegible] of [illegible]
[illegible]waii	50,000	60,000[2]	+ 20	7,000	na	na		
[illegible]izona	53,500	75,000	+ 40	3,304	24,000	5,160	32	7
[illegible]w Mexico	46,000	75,927*	+ 65	6,372	6,995	7,581	9	10
[illegible]vada	13,000	20,500	+ 58	3,360	9,600	4,200	47	21
[illegible]ah	19,000	33,000	+ 74	2,687	na	na		
[illegible]orgia	75,000	100,000	+ 33	2,012	23,308	21,837	23	22
[illegible]ntucky	66,705	76,820	+ 15	2,241	13,558	12,455	18	16
[illegible]rginia	73,423	80,000	+ 9	1,590	14,400	14,202	18	18 [illegible]
[illegible]linois	177,539	164,287[1]	- 7	1,463	27,702	23,785	17	15
[illegible]diana	135,000	137,723	+ 2	2,602	na	na		
[illegible]chigan	127,500	138,000	+ 1	1,516	na	na		
[illegible]ode Island	18,000	23,000	+ 28	2,481	na	na		
[illegible]ssachusetts	120,000	129,656	+ 4	2,238	na	na		

[illegible]s of 9/17/79.

[illegible]here are also 1,603 firms registered under the hotel tax; an estimated half of these are a[illegible] [illegible]gistered under sales tax.

[illegible]lus 30,000 lessors of real property

of active accounts. In any event, the numbers in the midwest states and Massachusetts have not increased materially in a decade. The number of vendors per 100,000 population is between 1,200 and 3,300 in all of the states except the two with very broad bases covering services as well as goods--Hawaii and New Mexico, and to a lesser degree Arizona.

One of the most surprising features of sales taxes is the very high turnover of businesses each year, as shown in Table 1. The figure is typically from 15 to 25%--that is, the percentage of vendor establishments either sold during the year or closed down and an equivalent number of new vendors established. This turnover creates a constant problem of reeducating vendors. New Mexico conducts annual taxpayer workshops throughout the state in an effort to educate the tax paying public and legal and accounting practitioners.

III. ADMINISTRATION AND OPERATION

Changes in administration and operation are not easily measured, but some indication is feasible, and various data about operation, enforcement, and audit can be updated.

The Tax Administration and Civil Service Systems

The top level administration structures have not basically changed in these states in the last decade. In all except two states, the administration is headed by a Commissioner, Director, or Secretary of Revenue, and/or Taxation (in Rhode Island, Tax Administrator). These persons are directly responsible to the Governor except in Michigan (responsible to the State Treasurer) and Rhode Island (to the Director of Administration). In Nevada, the tax department is technically under the Tax Commission, with 7 members appointed by the Governor. But the operation is headed by the Executive Director. Utah has administration headed by an appointed Tax Commission,

[illegible] operations delegated to some degree to [illegible] There is no executive secretary or director as in the other states. A significant change occurred in Nevada in 1975, when the administrative unit was designated as the Department of Taxation. New Mexico has merged the various revenue agencies into a Department of Taxation and Revenue, the old Bureau of Revenue becoming the Revenue Division.

The status of the head of the revenue administration extends over a substantial range. In Rhode Island and Michigan, the top positions are civil service, career appointments. In Virginia, New Mexico, Utah, and Arizona the positions lack civil service status but have tended to be career appointments. This had been true (of the Chief Auditor) in Utah until recent years. In Nevada the executive director has changed with the state administration, but persons have served for long periods; the present director served under the previous Republican administration and his predecessor, for eight years under a Democratic regime. In all of these states, and to a large degree in Kentucky, most of the persons in the office have had substantial background in taxation. In Hawaii, Georgia, Massachusetts, Indiana,[1] and Illinois the persons appointed often have had less background in the field, and in some instances the appointments have been made strictly on political grounds. Few persons have held the position for any length of time in Illinois, even under the same Governor.

All of this group of states except Indiana have general civil service or merit systems, which ensure appointment on the basis of specified qualifications (which of course may not be adequate), and retention on a nonpatronage basis. Except in Rhode Island and Michigan, the director and assistant director or directors are not covered by the merit system requirements. The degree of discretion of the revenue departments in hiring, however, varies.

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[1] The present Indiana Commissioner, however, is a CPA with extensive state government experience.

In some states, choice must be made from the top three names; in others, the department may reject all names and ask for additional ones. The Illinois Revenue Department has particular freedom, but must hire from the qualified list. In a few instances, in technical positions, a department may hire directly, but the person must pass the prescribed examination within a six-month or other interval. In New Mexico, policy is to promote from within the department when possible.

In Indiana, one of the last remaining patronage states in this field, the auditors are under a merit system, but other employees are not. The patronage is divided 60-40 between the party in power and the minority party. Since 1969 all governors have been Republican so there has been little turnover and some employees are still carried over from the previous Democratic regime. But on the whole there is little merit in the selection process and little assurance of permanence. In Illinois there is some political influence in the hiring of revenue collection officers, but they are subject to civil service. In general practice has changed little in these 13 states in the last decade.

Organizational Structure for Sales Tax Administration

At the one extreme, Arizona still retains a sales tax division with full responsibility for the operation of the tax, including both audit and enforcement, a pattern once common in a number of states. But consideration is being given to functionalization, initially of enforcement. The structure in Nevada, which has no income tax, is similar. There is no sales tax division, per se, and operation is integrated with the other taxes (except on gaming), but the sales tax is completely dominant. In Indiana, the Sales Tax Division has substantial responsibility, including enforcement, but not audit.

Five of the states have sales tax divisions without a field force, which is centralized for all taxes: Virginia (where the division plays a major role in audit selection), Kentucky, where the division reviews audits, Michigan, Georgia (with some audit selection role), and Massachusetts, where the role is largely interpretative. Rhode Island has a small sales tax unit in the assessment unit, but with minor functions.

New Mexico and Illinois are at the extreme: there is no sales tax division (except in Illinois, in the tax processing section), functions being completely integrated. Hawaii is moving toward this pattern. Utah is unique: while the organization is completely integrated, there is a sales tax unit within the audit division which has primary responsibility for the sales tax, although to a degree sales and income tax audit are integrated.

There is a continuing trend toward functional, rather than type-of-tax, organization, which began in the sixties. Of this sample of states, in the last decade Georgia and Massachusetts have moved from sales tax units with all functions to functional audit and enforcement, and Virginia and Hawaii have moved farther in this direction. This shift, designed to make better use of field personnel and lessen nuisance to vendors, has not met with universal approval; responsibility for this major tax is divided among various persons, and, as noted later, sales and income tax audit are often not in fact fully integrated. This trend toward functional organization was very noticeable prior to 1970 as well.

It is obvious from visits to state revenue departments that the primary responsibility and authority over sales tax operation often cannot be determined from organizational charts. For many years, for example, in Utah, the audit division has been very powerful, the Chief Auditor and the Manager of the Sales Tax Audit unit largely controlling the operation of the tax (with emphasis on

audit rather than enforcement), whereas in neighboring Nevada, the prime authority rests with the Chief of Revenue, who has charge of enforcement, rather than with audit.

Major Types of Personnel

While the exact personnel structure varies, all of the sample states except Hawaii have two basic types of personnel who work in the field, as distinguished from the headquarters personnel: auditors, and enforcement personnel. By contrast, in 1970 Michigan and Massachusetts had combined audit and enforcement staffs. The designations of the enforcement personnel differ widely: field representative is a common term, but they are known as Revenue Officers in Rhode Island and Nevada, Collectors in Michigan, Field Collectors in Arizona, Revenue Collection Officers in Illinois, for example.

There are additional classifications in some states (plus clerical, bookkeeping, data processing, etc., personnel). For example, in Nevada there is a tax examiner group with tax training which handles phone calls, routine enquiries, etc. Both Arizona and Georgia have separate collection units for the hard core delinquents for which legal action is necessary, and Illinois has an investigation unit. New Mexico has a specialized Tax Fraud unit, intensively trained by the IRS to prepare audits for purposes of criminal prosecution.

Table 2 shows the size of the field staffs in the 13 states. Exact comparison is impossible, for several reasons. The method of defining the number of accounts varies. In some states it is not possible to estimate accurately the time allocated to sales tax audit compared to that on other taxes. But the figures give some rough approximation for comparison among states and determining trends.

Table 2

Sales Tax Staff
1977-78

State	Enforcement Personnel		Auditors		Accounts Per Auditor	
	1970	1978-79	1970	1978-79	1970	1978-79
Hawaii		--	45	45	1,250	1,333
Arizona	10	17	30	41	1,783	1,829
New Mexico	30	33	45	40	800	1,831
Nevada	15	14	22	28	591	1,139
Utah	5	8	25	35	760	943
Georgia	70	na	85	40	882	2,500[3]
Kentucky	97	97	25	62[2]	2,667	1,239
Virginia	90	33[1]	74	104[2]	992	769
Illinois	109	54	187	216	949	771
Indiana	36	35	100	288[2]	1,350	478
Michigan	na	91	100	188[1]	1,775	1,099
Rhode Island	12	20	35	37	514	622
Massachusetts	na	68[2]	45	83[2]	2,667	1,562

[1] Adjusted, so far as possible, for allocation of time to sales tax work.

[2] Unadjusted for time allocated to nonsales tax audit, but most of work is on sales tax.

[3] Misleading, as much of the audit is done by the field representatives.

The number of accounts per auditor is shown in Table 2. Seven of the 13 states--all the western states, plus Georgia and Rhode Island--show an increase in the number of accounts per auditor; in three of these the change is very marked. The others show an improvement. But only five of the states show figures below the 1000 mark, which is roughly an indicator of minimal adequacy. The optimal figure is likely closer to 500. On the other hand, only one exceeds 2000. The western states have experienced a sharp growth in the number of accounts, and have not increased the number of auditors in proportion.

Table 3 indicates the salary levels of auditors in the sample states. It is difficult to make a precise comparison among the states, but it is obvious that the variation is substantial. The southern states, plus New Mexico, Hawaii, and Massachusetts, appear to run about $2,000 below those in the other states for comparable levels. Michigan is the best paying of the group. Exact measurement of the changes since 1970 is difficult; but very roughly the salary schedules appear to have kept pace with inflation.

Graduates in accounting from the University of Illinois in 1979 going into public accounting received on the average a monthly salary of $1,292, into industrial accounting, $1,215.

Personnel Qualifications

It is difficult to get a clear picture of the actual requirements for the various positions and the typical backgrounds of the persons hired. But a general picture is possible.

Auditors. All of the states require knowledge of accounting, gained either through college work, experience, or both.

Table 3

Monthly Salary Ranges, Sales Tax Auditors, 1978-79

State	Trainee	Beginning	Experienced	Senior	Supervising	Top Level
Hawaii		987-		-1491		
Arizona		1101-1450	1289-1693		1506-2047	
New Mexico	827-1164	958-1348	1056-1485	1221-1319	1282-1805	1348-1896
Nevada		1148-1577	1314-1813	1375-1898		
Utah	1001-1461	1106-1616	1231-1799	1390-2029	1543-2251	1716-2773
Georgia	891-1279	1065-1538	1166-1689	1279-1853	1403-2029	
Kentucky	862	905	951	1155	1338	
Virginia	916	956-1306	1294-1429		1094-1492	1250-1708
Illinois	977	1033-1521	1145-1689	1357-2283	1731-1949	
Indiana	1060-1365	1207-1541	1365-1740	1541-1974[1]	2067-2763	
Michigan	1205-1434	1332-1669	1517-1809	1628-2042	1787-2233	
Rhode Island		1142-1338	1338-1509	1445-1634	1879-2131	
Massachusettes		917-				

_______ indicates salary range of most of the auditors.

[1] called supervising

p. 12 a to "State Sales Tax Structure and and Operation in the Last Decade -- A Sample Study", Faculty Working Paper #627, College of Commerce, University of Illinois, November 16, 1979.

In addition to Arizona, noted below, Rhode Island, Kentucky, and Illinois are the states most insistent on a college degree with a major in accountancy, or at least 12 hours in accountancy (Illinois). All indicate that they are able to acquire the persons that they want--usually young persons just completing university work, the long standing tradition in California. Michigan, Hawaii, and Massachusetts also stress college degrees, accepting business administration degrees as well as accounting majors. Arizona is in a sense the strictest, requiring both a degree in accountancy and at least two years experience, thus barring new university graduates.

Four states, Georgia, Nevada, New Mexico (which once did require a college degree) and Virginia, require either a college degree in accounting or experience, allowing substitution of experience in the field for university work. Most of the persons hired in Nevada do not have college degrees in accounting, but are older persons with substantial experience in auditing and accounting work. Indiana requires knowledge of "college level accounting", regardless of how acquired.

Most of the states report that they can get the types of persons they wish; but Massachusetts reports a serious shortage of personnel in the auditing field, and several states, an inadequate number of positions. The states stressing recruiting directly from universities typically do not get the top graduates, except in years when private business is doing little hiring.

The general pattern of qualification requirements has changed little in the last decade, New Mexico backing away somewhat from the strict requirement of a college degree. Although not required to do so, New Mexico's policy is to hire at the entry level.

Field Representatives--Compliance and Enforcement

All of the states have separate enforcement and compliance personnel; only in Georgia do they perform some small scale audit as well. Otherwise their tasks are confined to giving information to taxpayers, making certain that all vendors are registered, contacting delinquents, tracking down bad checks, etc. The numbers were shown in Table 2. Most states have fewer enforcement personnel than auditors, but the ratio varies substantially. The numbers have not changed significantly since 1970.

The qualifications for enforcement officer are substantially different from those for auditor. Nevertheless, four states in the group, Rhode Island, Utah, Virginia, and Kentucky require a college degree, and in Virginia, collection experience as well. Massachusetts and Nevada stress the need for persons with collection experience, Michigan and Indiana, business experience generally. Illinois requires a college degree or the equivalent; about half d the degree. Illinois stresses recruiting younger people more than most states The trend has been to require greater qualifications than a decade ago.

The salaries and the number of enforcement officers are shown in Table 4. The beginning salaries are extremely low in today's labor market; only the usual ability to hire above the beginning rank makes it possible to obtain experienced personnel at all. But only Rhode Island, Michigan, Utah, and Nevada and Illinois pay what might be regarded as a going wage for this type of work. Illinois reports very little turnover of collection personnel.

District Offices

There are district offices in all of the sample states except Rhode Islanc where all activities are concentrated in Providence, and Arizona, where there i a regional office in Tucson, but no district offices. The number ranges from

Table 4

Monthly Salaries, Compliance and Enforcement Personnel

1978-79

State	Beginning	Experienced	Senior	Supervisor
izona	$ 903-1,152	$1,029-1,318		
w Mexico	751-1,056	757-1,109	$ 958-1,348	$1,221- 1,719
vada	1,200		1,653	
ah	1,001	1,231-	1,799	
orgia	759-1,064	822-1,166	891-1,166	973- 1,403[1]
ntucky	710-	782	951	
rginia	875-	916-1,250	1,044-1,429	1,140- 1,558
linois	979-1,449	1,105-1,629	1,225-2,160[2]	1,638- 2,442
diana		716-	900	
chigan		1,206-1,435	1,332-1,512	1,780- 2,250
ode Island		1,015-1,191	1,142-1,338	1,338- 1,509
ssachusetts	667-			

elinquent tax collector.

overs two salary ranges.

three in Nevada and five in Utah, to 15 in Illinois plus the regional office in Chicago; 13 in Indiana, and 9 plus sub-districts in Michigan. In general, the district offices handle both audit and enforcement work, although in Utah, a state that stresses audit work, they are involved primarily in audit. The activity involves provision of information to taxpayers, supervision of collection work, and assignment of audit to particular auditors. The district offices do not make basic audit selections, but may have discretion in assignment of audits from the lists provided. This is particularly true in Illinois. Nor are taxpayer basic files kept in these offices. The lone exception is Hawaii, with complete decentralization. All taxpayer files are kept in the four district offices (one on each of the major islands) and all audit selection is made in the district offices (as it is in California).

In all of the states with district offices the auditors are assigned to the district offices (to regional offices in Arizona) but not to particular areas within the district. By contrast, the enforcement personnel are not only assigned to district offices (except in Utah) but also to particular areas--counties, portions of cities, etc., being responsible for all enforcement in their areas. In Arizona, however, they are frequently rotated from one territory to another.

In most of the states, the person in charge of the district office has an audit background, but in Nevada, typically an enforcement background. In most of the states at least the larger offices will also have an audit supervisor, who assigns and reviews audits. Illinois district offices have both audit and collection supervisors.

Training Programs

The training programs remain very limited, as they were a decade ago. The Illinois program is the most complete, with four weeks formal classroom

training, for both new audit and collection personnel, and then work under senior personnel after assignment to the district offices. The Indiana program is similar, alternating formal class work with on the job training, following an initial 30 to 45 day training for new auditors. Michigan provides a 3 week formal training program for auditors, one week for enforcement personnel. New Mexico provides one day a week formal training in conjunction with on-the-job training, over a 12-week period. Rhode Island and Kentucky provide 2 weeks initial training in headquarters before sending the person to work with senior personnel. The other states do not have formal training programs; after a brief orientation, the newly hired persons work on the job with senior personnel. One problem facing many states is that the number of new persons taken on for audit or enforcement in any one year is so small that formal classes are not feasible. By contrast, Illinois hires 15 to 20 new auditors at one time.

Data Processing

With the modern complex computers, the trend has been toward central administration computer systems, the revenue department sharing with other agencies. Of the sample states, only Illinois, Arizona, and Massachusetts revenue departments have their own systems. In Michigan, the Treasury, of which revenue is a part, has its own. Most of the states report only minor problems with scheduling computer time. New Mexico and Virginia report some.

The installations vary widely. As a decade ago, IBM is the most common (Hawaii, New Mexico, Nevada, Kentucky, Virginia, Rhode Island), but the 370s have replaced the 360s. Univac (Sperry) 9080s are used in Illinois, Arizona, and Massachusetts, Burroughs B6700 in Michigan, an ITEL installation in Utah. Indiana, alone of the states, does not use a state system, but contracts the computer work to a private firm, which uses NCR 200 and 201 equipment.

A basic change is the trend toward third generation computers that allow on-line direct access to the information on any account, via video unit and/or hard copy, with enquiry terminals in the district offices as well as headquarters, and with entry of data into the system at headquarters video units. The four states that have fully attained this system are Nevada, New Mexico, Michigan, and Rhode Island (which of course has no district offices). The Illinois system allows direct access, but not all desired information. Such a system saves a great deal of time and routine shuffling of paper. Entry of data is far simpler and editing (verification) is much easier than under the old punch card systems.

The other computer systems have moved toward the optimal in varying degrees. Kentucky has accounts receivable information on direct access; Indiana has limited direct access; the other states do not. Georgia and Massachusetts and in part Utah still enter data into the system via punching of cards, Utah in part using diskettes, from which the data goes onto magnetic tape. Access is sequential only, and these states therefore work from printouts. Any of these systems (except in Massachusetts) will of course provide the lists of delinquents and address the copies of the returns and delinquency notices. Most of these states have plans for on line video units and direct access; only Utah reports low priority for the change, in the belief that the change is too costly relative to the benefits.

Registration of Vendors

The system of vendor registration has not changed significantly. All states provide an application form. Five of the states, Illinois, Utah, Kentucky, Georgia, and New Mexico, do not charge a fee and the registration is valid indefinitely. Four additional states provide indefinite registration but charge a fee: $3 in Nevada, $5 in Rhode Island and Virginia, $10 per store

in Massachusetts, a sharp change in policy. Arizona issues the registration permits for 5 years, at a charge of $1. As a decade ago, three of the states in the sample, Michigan, Indiana, and Hawaii, require annual renewal, at fees of $1, $3.50, and $3 respectively. The main advantage of annual renewal, a source of some nuisance, is to weed from the master file firms no longer in business.

Vendors are coded by type of business in all of the sample states except Utah, Hawaii (which tried SIC and abandoned it, now going to its own) and Massachusetts. SIC (Standard Industrial Classification) code is used in Michigan and New Mexico, and with some modifications, in Illinois; Arizona and Utah are moving to it, and Nevada classifies firms by it but is still using its own simpler code. Kentucky and Georgia (and Tennessee) use a uniform 2 digit code developed by these 3 states; Rhode Island, Indiana, and Virginia use their own codes. The net result of this diversity is to make comparison of yields by category of store among the states almost impossible. There is no evidence of shift toward greater use of SIC. The actual registration number is typically simply sequential, with codes indicating location, ownership pattern, etc. Michigan and Nevada use the Federal employee identification number when available; Hawaii uses the same number for sales and income tax, as does New Mexico with corporations.

Returns

All except four of the states in the sample mail out the return forms (addressed by the computer) at the appropriate time in each reporting period. Massachusetts and Rhode Island mail three times a year, Hawaii quarterly, Michigan only once a year. Illinois is considering quarterly mailing. Mailing at infrequent intervals lessens mailing costs but loses the advantage

reminding the firms that a return is due. Rhode Island, unlike the other states, does not designate the month on each return.

Only four of these states use card return forms, Rhode Island, Massachusetts, Virginia, and Kentucky, and the last-named is changing to paper returns. Cards are prepunched and therefore can easily be sorted by account number after being processed. The others believe that cards do not permit reporting of adequate information. This picture is unchanged over the decade.

Return Intervals

A trend that began in the sixties continued through the seventies: the tendency to place smaller firms on a longer return interval than the large accounts. All thirteen states in the sample use more than one interval (Table 5). But in several states, Arizona, New Mexico, Illinois, Kentucky, and Rhode Island, the monthly interval remains dominant. New Mexico and Illinois do not use quarterly intervals, placing the low tax firms on semi-annual and annual bases. Only in Hawaii and Massachusetts, with very high eligibility figure for quarterly returns, and Utah is quarterly dominant. The figures for the two intervals are nearly the same in Nevada. Six of the states do not use, except incidentally, periods longer than quarterly. In 1970, by contrast, Arizona and New Mexico used only monthly returns, with minor exceptions. Illinois abandoned the quarterly interval to save processing time.

The monthly tax liability figure that qualifies a firm for quarterly filing varies from $10 in Virginia and Indiana to $100 in Massachusetts and $166 in Michigan, with the withholding tax liability being added to the sales-use tax liability. Semi-annual returns are authorized in one state, New Mexico, and annual in 7, typically when the annual tax liability is less than $100 ($200 in Michigan). The Illinois figure for annual returns is monthly tax liability under $20.

Table 5

Sales Tax Return Intervals, 1979

State	Eligibility for Quarterly Return Monthly Tax Under: (Dollars)	Eligibility for Semi-Annual Return Monthly Tax Under: (Dollars)	Eligibility for Annual Return Annual Tax Under: (Dollars)	Number of Vendors by Return Interval			
				Monthly	Quarterly	Semi-Annual	Annual
Hawaii	41.66	--	--	na			
Arizona	16.70	--	100	63,000	12,000[2]		
New Mexico	--	50	--	54,459[4]	--	21,1[illegible]	
Nevada	all	--	--	11,000	9,000	200	
Utah	all	--	100		26,000		7,000
Kentucky	15	--	25	59,640	7,248	402	13,[illegible]
Georgia	50	--	--	66,000[3]	33,000[3]		
Virginia	10	--	--	60,000	20,000		
Illinois	--	--	240	132,709	--	--	[illegible]
Indiana	10	--	10	84,965	22,601	10[illegible]	[illegible]
Michigan	166.67[1]		199	80,953	38,826	--	[illegible]
Rhode Island	50	--	--	21,300	1,689		
Massachusetts	100	--	100	19,700	63,000		[illegible]

[1] Sales, use, and withholding.

[2] Including annual.

[3] Approximate.

[4] As of 8/17/79.

Automatic assignment by the computer, usually reviewed annually, is the practice in Massachusetts, Indiana, Virginia, Kentucky, and Arizona; firms eligible for the quarterly or longer basis must apply in Rhode Island (less than 20% do), New Mexico, Hawaii, and Illinois. In Nevada, alone among the states, the firm has complete choice, but, as noted below, a larger security bond must be provided if the quarterly basis is used. Most of the older firms use the quarterly interval, even though they are large; most newer firms, the monthly. Hawaii alone requires a summary annual return of all vendors, which serves as the basis for audit review.

Illinois utilizes a prepayment plan, designed to bring in the tax revenue from large firms more quickly. Firms with monthly tax liability in excess of $10,000, of which there are 1,944 (1979) must pay on a 4 times a month basis, on specified dates. Prior to October 1, 1979, firms with monthly liability between $5,000 and $10,000 were required to either make a deposit equal to the average monthly payment (441 firms) or pay on the last day of the month of the return period (1,981 firms). Virginia developed a prepayment plan but abandoned it because of the opposition of business firms.

Concentration of Revenue from Large Returns

Few states collect statistics of the total tax revenue received from returns of various magnitudes, but all agree that a very large portion of the revenue comes from a small number of firms. The following table, condensed from a more detailed table compiled by the state of Kentucky, is likely to be resonably typical of other states as well.

Monthly Average 1978

Amount of tax due	Number of Returns	Percentage of Tax Returns	Percentage of Tax Paid
No operations, or no tax due	10,670	17	0
Tax under $10 mo.	17,972	28	.4
Tax under $100 mo.	35,637	56	2
Tax under $500 mo.	51,713	81	11
Tax under $1000 mo.	56,863	97	36
Tax under $10,000 mo.	63,089	99	55
- - - - - - -			
Tax over $10,000 mo.	482	.8	45
Tax over $25,000 mo.	155	.25	35
Tax over $50,000 mo.	70	.1	28
Tax over $1,000,000 mo.	34	.05	22

Source: Data supplied by Kentucky Department of Revenue.

Thus the top 1% of the taxpayers, numbering 482, pay 45% of the tax; the 81% of the vendors paying less than $500 a month provide only 11 percent of the tax.

In Utah, 1 percent of the accounts pay 40% of the tax.

Delinquency

The principal form of delinquency for sales tax is the failure to file returns and pay tax due, although in some instances returns are filed without payment, and bad checks are presented.

The Time Sequence. The returns are due on the 15th in two states (Arizona and Michigan), the 20th in five, the 25th in New Mexico, and either the 30th or the last day of the month in the other five states (Hawaii,

Nevada, Utah, Illinois, and Indiana). Most states allow a day or a few days grace before actually assessing penalties but do not advertise this fact. Extensions of time are denied in two states (Hawaii, Illinois), granted in the others, some temporary only (Nevada, Rhode Island), others both temporary and permanent (the latter mainly for large firms doing business in a number of states, with accounting systems such that the meeting of the deadline is difficult).

The states fall into several groups as to the number of days allowed to elapse after the due date before action is taken against the delinquents (non filers), the time varying slightly from period to period because of weekends, holidays, etc.:

10 to 12: Nevada, Utah

15: Michigan and Rhode Island, and the objective in Hawaii

25: Kentucky, Virginia

end of following month: Arizona, Hawaii

2 to 2½ months: New Mexico*, Indiana

In Illinois, action is based on 45 day interval printouts of delinquents, so that the time period before action depends on the relationship of the filing cycle and the delinquency printout cycle. Most are not contacted until 3 months have elapsed.

Quarterly, four to five months: Massachusetts; Hawaii in practice in the past.

It is evident from experience that too short an interval results in wasted action since many of the returns will come in anyway. But some states, mainly because of lack of man power, are losing substantial sums of interest as well as tax payments by the long interval.

In all states except Illinois, the first action against non filers is a notice to the taxpayer, addressed by the computer. This may take the form of

*A computer generated "non-filed notice" is mailed between 30 and 60 days from due date; follow-up contact is made by enforcement officer at 2½ months.

another copy of the return (Hawaii), or a printed notice. In Nevada, the field is notified for immediate contact; the other states do not do this until additional time has elapsed. In Illinois, no notices are sent; a phone call or visit is the first action taken, but often not for a long period after the preparation of the 45 day delinquency list. After a firm has been delinquent three months, the computer provides a special notice to the district office.

The second action comes typically about a month after the first notice is sent out. Some states, such as Utah and Rhode Island, rely primarily on a second letter. But typically at this point the field officers are notified--sometimes by a listing, sometimes by a duplicate copy of the taxpayer notice--to take action. They are usually sent through the district offices, but with the usual pattern of assigning enforcement personnel to specific areas, each enforcement officer is responsible for the delinquents in his area. Increasing stress is placed upon contact by phone, in several states initially by staff in headquarters before referring to the district offices. Beyond this second action, the usual procedure is to depend on the field personnel, before final action is taken.

Decision on the final action on the hard core delinquents who will not (or cannot) pay is made in some states in the district offices (e.g., Illinois), in others by the enforcement supervisor in headquarters. As was true a decade ago, the states vary substantially in their policies on the hard core delinquents. The most common approach is through the preparation of a warrant (which usually becomes a lien), authorizing the seizure of property to obtain the money. Meanwhile, a formal assessment has been prepared, on the basis of previous tax paid. In other states, a lien is filed at an earlier date than the warrant, to protect the interests of the state in the event of bankruptcy.

Some states, such as Illinois, are vigorous in actually seizing property (recently, in Illinois, one was a large furniture chain); others are reluctant to seize, but use the warrant mainly as a means of pressuring the firm to pay. One problem with the warrants is that in most states, cooperation of the sherrif is necessary to execute them, and this is not always forthcoming. Nevada, in addition to lien, takes the bond, required of all firms.

Two states, by contrast, namely Kentucky and Rhode Island, rely primarily on the threat to revoke the registration certificate, and, finally, actual revocation, and Nevada and Utah to a lesser extent. This is the system long used California. The notice to the taxpayer that a hearing will be held on revocation usually enough to bring forth a return and payment. If the firm continues to operate after revocation, criminal charges are brought against the firm for operating without a certificate. Not all states have the power to revoke, and the others that do have not found this to be a satisfactory method, mainly because the courts are very lenient with those operating after revocation.

It is obvious that there is no one ideal method for dealing with the hard core firms; the most effective weapon depends upon the traditions, the attitude of the courts and the sheriffs, and other characteristics of the state.

The Number of Delinquents. It is impossible to provide a precise comparison of delinquency experience by state, because of different time periods before delinquents are ascertained, and the relationship between the reported figures of numbers of vendors and the actual number of active vendors. But the figures in Table 6 give some rough comparisons.

Table 6

Delinquency Experience

State	Number of Delinquents in each Filing Period as Percent of Active Accounts		
	1960	1970	1978-79
Utah	7	7	4
Michigan	6	5	5-7
Kentucky	6	7	6
Nevada	6.5	10	5-8
Virginia	--	7.5	7.3
Georgia	8	4.5	9
Indiana	n.a.		9
Illinois	6.5	7.5	10 est.
Arizona	n.a.	12	11
Rhode Island	11	10	13
Hawaii	n.a.	n.a.	7
New Mexico	n.a.	20 est.	7.4

No data are available for Massachusetts.

Several states, particularly Utah and Nevada, have shown substantial improvement since 1970, but most have remained much the same, and the Illinois estimate for 1979 is much higher than the earlier figures. It is by no means clear why such states as Arizona and Rhode Island with good tax administrations cannot bring the delinquency figures down.

For several states, relatively accurate information is available for the numbers of delinquents remaining at various stages in the enforcement process.

Table 7

Delinquents at Various Stages in the Enforcement Process

State	Percentage of Accounts Delinquent		Final Action
	Initially	At time of Second Action	
Arizona	11	7	.3
Nevada	5-8	3	n.a.
Utah	4	3	2-warrant
Kentucky	6	4	.4[1]
Virginia	7.3	3.6	n.a.
Illinois	10	--	.2
Indiana	9	7	2[2]
Michigan	5-7	$2\frac{1}{2}$-$3\frac{1}{2}$	n.a.
Rhode Island	13	7	1-hearings to revoke[1] .1%-revoke[1]
New Mexico	7.4	3	n.a.

1. In a year. 2. Sent to collection division.

Thus from one-fourth to one-half are usually cleared by the first notice without field contact (and many of these firms would file even without the notice). The hard core is an extremely small number--from .01% to up to .3% of the vendors actually are subject to final drastic action in a year--actual revokation or closing of the business. But the threats of these actions are highly important in leading firms to file.

Penalty and Interest. The penalty for nonfiling provisions remains much the same as a decade ago. Four of the states, Hawaii, Kentucky, Virginia, and Michigan, impose the steepest penalties, 5% a month to a maximum of 25%. Five others, Indiana, Arizona, Nevada, Utah, and Illinois, have 10% penalty figures; New Mexico begins at 2% and rises to 10%. Nevada now has an unusual provision; while the basic penalty is 10%, it can be reduced, upon request,

for good reason to 2, 4, 6, and 8% if the delay in filing is under 2, 5, 10, and 15 days respectively. Kentucky and New Mexico have dollar minimum penalties ($10 in the former, $5 in the latter). Most states have raised their interest charges, to 8 or 12%, but Arizona and New Mexico remain at 6%.

The Sources of Delinquency. Few states make any systematic enquiry into the type of business or geographical area showing the highest rate of delinquency. Kentucky is an exception, with detailed data by type of business. Nevada reports bars, cafes, repair shops, and small used-car dealers; Michigan, gas stations, restaurants and bars; Illinois, small restaurants and gas stations (bars are effectively controlled through cooperation with the Liquor Control Commission). In some states the delinquency record varies with the area of the state. In Nevada, for example, delinquency is highest in Las Vegas, least in eastern Nevada.

A high percentage of all delinquents is found to owe no tax; the estimate in Arizona is half, a factor in that state's high delinquency percentage. The result is wasted effort and expense. This is the chief justification for an adequate dollar minimum penalty, perhaps $10.

Surety and other Bond Requirements. The majority of the states in the sample do not use a bonding requirement; Utah tried it and found it more trouble than it was worth. Many of the laws permit the revenue department to require bond, with the decision made by the department. Arizona and Hawaii are exceptions. Limited use is made in New Mexico (out-of-state contractors, some delinquents); Kentucky (transient vendors, delinquents); and Rhode Island (out-of-state contractors). Special accounts are required for certain firms with poor payment records.

The only two states in the sample to make general use of bonding are Illinois and Nevada. Illinois requires bond of all new firms, releasing them after a three-year period if their payment records are good. The amount

of the bond required is 3 times the estimated monthly tax liability, with a maximum of $50,000. Bond is also required of delinquents. Nevada is the only state that requires a bond of all firms without exception and never releases them. The amount is 3 times the monthly tax liability, 2 times the quarterly liability, with a dollar range from $30 to $20,000. Each quarter the computer reviews one-fourth of all the accounts to ensure that the amounts of the bonds are adequate. The system is a source of some nuisance, but the state continues to adhere to the requirement.

In both states, as well as those making incidental use, a wide range of forms of bond are accepted: surety bonding, cash, TDC, which is the most common in Nevada, savings deposit books for small firms, and in a few instances pledges of real property.

No state in the sample has moved toward greater use of bonding, and Michigan, like Utah, has moved away from it as the revenue department found the system to be a major source of headaches. Instead, the state places certain types of firms on a probationary status, requiring them to pay directly to the district office where delinquency is checked the day after the due date and immediate contact made if the return has not been filed.

Audit

The most important key to successful sales tax administration is an effective audit program, to ensure that firms are paying correct amounts of tax.

Integration of Audit. As noted above, the states have been moving more and more toward integration of audit of sales and other taxes, particularly corporate income tax. Of the states in the sample, the audit structure is integrated in all except Arizona (Nevada, of course, has no income tax). But the actual degree of integration varies.

The most complete integration in fact appears to be in Michigan, Kentucky, and Indiana, in which auditors do audit all of the taxes. Michigan reports complete success. New Mexico, Illinois, and Hawaii essentially have integrated systems, although the bulk of the time goes into sales tax audit, and in Illinois, audit selection is primarily on the basis of sales tax. Rhode Island has integration--but the auditors that do sales tax do not do corporate income tax, handled by a special group. Utah, a pioneer in audit integration, has two separate sets of auditors, sales and income, each trained in both types of taxes, and frequently doing both--but with substantial specialization. In the other three states, Massachusetts, Georgia, and Virginia, audit is integrated in structure but primarily not in fact, the auditors being specialized by type of tax, the sales tax auditors normally doing only sales tax work.

Selection of Accounts for Audit. Since only a small percentage of accounts is audited each year (although an audit usually covers three years), selection of those to be audited is important for the effectiveness of the audit program. Selection is made basically in headquarters in all of the states, although in some, such as Illinois, the field offices do have option in selection from the list of priority firms provided by headquarters, and in most states some of the audit leads are suggested from the field.

For two decades various states have considered and experimented with the use of EDP equipment for the selection of accounts for audit--but little progress has been made, and one of the pioneers in the experiment, Michigan, has backed away from it. Only one of the states in the sample is actually using EDP equipment in selection (beyond the routine printing out of the list of firms by size of tax payment and date of last audit), namely, Illinois, and Illinois does so only in the sense of computerization of the past data

of audit experience with the firm and similar firms. Rhode Island and Indiana are considering computer selection, and Rhode Island is establishing norms to do so.

The most scientific approaches to selection are found in Michigan and Illinois. Michigan, after abandoning computer selection, follows the California cell system, firms being classified into cells on the basis of the type and size of business, with priorities established according to past experience with each cell. Illinois classifies into three groups for priority, the classification being based primarily on past audit experience with the particular firms. With somewhat less scientific techniques, Utah, Kentucky, Arizona, and Nevada all place substantial stress on past experience, and emphasis maximization of dollar return from audit. Nevada audits all casinos on a cycle (large, 18 month, small, two years). New Mexico currently relies primarily on leads from other audits; Virginia, Kentucky, and Indiana all place considerable emphasis in selection on leads and referrals.

Massachusetts lists a wide range of criteria, including those noted above as well as type of industry and comparison of the ratios of deductions to taxable sales among firms. Hawaii is one of the few states to place emphasis upon office audit of returns (using the annual returns) as a basis for selection of accounts for field audit. Several states stress the intuition of the senior auditors in picking out the most productive audits. While Massachusetts and Rhode Island both note deviations from norms in such matters as ratios of exempt to taxable sales, it would appear that on the whole the states have been moving away from the norm approach, which appeared so promising a decade ago. It is clear that not much progress has been made in establishing more scientific approaches to selection.

<u>Audit Procedures</u>. Few changes are discernable in audit procedures over the last decade, and the various elements need not be reviewed. Stress is always placed on the use tax side, as here the most frequent mistakes are made: failure to account for tax on goods bought from out of state or tax free under resale certificate and then used for taxable purposes. Illinois, for example, finds that use tax errors account for about 60% of the assessment, sales tax for 40%, of which 70% is from overstatement of deductions, 30% from unrecorded sales.

<u>Audit Coverage</u>. Table 8 shows the percentage of accounts audited annually, for the past year and 1969. Only 3 states, Utah, Rhode Island, and Nevada exceed or approach the 5% figure that may be regarded as a rule of thumb minimum figure, assuming competent audit selection. Four of the states have less than 2% coverage, with Massachusetts the lowest, at .9 percent. Eight of the 12 states for which data are available show a decline since 1979, mainly because the number of auditors had not kept pace with the increase in the number of accounts, although partly due to elimination of audit of accounts that show no additional tax due. Indiana shows the greatest decline; Virginia and Massachusetts the greatest increase (although the latter is still very low.

Of the eleven states for which recovery of tax from audit figures are available, 6 show figures of recovery as a percentage of total sales tax collection between .9% and 1.4%--in general less than the 1.4 to 1.7% of 1969. Rhode Island, with one of the most complete programs, shows the best, 4.4%, and Illinois, 3 percent. If audit is highly effective in leading to improvements in reporting, the figure should fall, not rise, over the years.

Few of the states indicate any specific objective in audit coverage. Michigan seeks to audit the large firms every four years, thus reaching all

Table 8

Sales Tax Audit Coverage, Sample States

State	Number of Accounts	1978-79 Accounts Audited Annually	1978-79 Percentage of Total Accounts Audited Annually	1969-70 Percentage of Total Accounts Audited Annually	Recovery from Audit (Thousands of dollars) 1978-79	Recovery from Audit as Percent of Sales Tax Revenue 1978-79
aii	60,000	1,200	2	3	na	na
zona	75,000	1,800	2.4	3.5	na	1.4
Mexico	73,000	2,000	2.7	3.1	4,842	1.4
ada	20,500	947	4.6	5.7	1,937	1.4
n	33,000	2,300	6.9	8.7	3,629	1.4
rgia	100,000		--	1.5	7,100[1]	.9[1]
tucky	76,800	1,106	1.4	1.0	11,567	2.2
ginia	80,000	2,750	3.4	2.0	4,300	.9
inois	164,287	5,500	3.3	2.8	71,005	3.0
lana	137,700	1,769	1.3	5.9	10,000	.9
higan	138,000	3,674	2.7	2.0	20,080	1.3
le Island	23,000	1,263	5.5	9.7	5,600	4.4
sachusetts	129,650	1,200	.9	.4	6,200	1.2

es not include audit by field representatives.

in that period, a representative share of the next group of priority firms, and small numbers of the others. Kentucky has a program of seeking to audit at least 200 accounts a month (all taxes). Nevada, Arizona, and Massachusetts indicate that their audit programs are inadequate; more personnel are required. By contrast, New Mexico indicates that it is reviewing its audit selection program to reduce the high percentage of no change audits in the sales tax area. Greater emphasis is being placed on auditing other tax programs such as severance and corporate income taxes. Virginia and Rhode Island believe their programs to be more or less optimal; 85% of the audits result in additional assessments.

Post-Audit Procedures. In all states, after the audit is completed, the auditor discusses his findings with the taxpayer and seeks to get his approval. Some states encourage the auditor to collect any tax due (Virginia, Illinois, Michigan); others permit but do not encourage it (Arizona, Indiana), others do not allow it (Kentucky, New Mexico, Rhode Island). In some states, for example, Georgia, Virginia, Illinois, Indiana, Rhode Island, the assessment of additional tax is made by the auditor, subject to revision upon review. In Arizona assessment is made by the audit supervisor; in Kentucky, by the sales tax division headquarters; in Arizona, by the audit supervisor; the other states in headquarters. In all states the audit findings are subject to review. In New Mexico and Illinois primarily in the district offices (in the former very little review is done in headquarters), by the audit supervisor or chief auditor in Arizona, Nevada, Virginia, after district office review, by the audit review section in Michigan. In Kentucky auditors in the sales tax division (which has no field force) make the review; in Indiana, a rotating group of senior auditors in Indianapolis.

Administrative appeal procedures are found in all states, to minimize court appeals. One pattern is an appeal directly to the head of the taxation division, as for example, in Hawaii, New Mexico, Nevada, Rhode Island. In [illegible], appeal may be made at an informal and formal hearing. The formal hearing is conducted by a full-time hearing officer who is not the head of the revenue division. In others the initial appeal is to the head of the sales tax unit--Virginia, Indiana, Massachusetts--or to the Sales Tax Audit Manager, in Utah. These appeals may involve a hearing before the Director, but more often to a hearing officer acting for him. In Illinois, these are practicing attorneys, some of whom devote most of their time to this work. In Utah and Nevada, the next appeal is to the Tax Commission, meeting occasionally for this purpose. Michigan has a tax appeals board, as does Arizona. The final appeal is to the courts. Some states report very few such appeals. Arizona reports about 50 a year, an unusually high figure.

Indiana is one of the few states to tabulate the appeals and disposals. In 1978, for all taxes, there were 3,051 audits; there were 457 protests against assessments from audit; 36% were withdrawn or denied; 43% partially denied, 21% granted.

IV. THE USE TAX AND OUT OF STATE PURCHASES

The overall problem of interstate transactions and approaches has not changed basically over the last decade, although two Supreme Court decisions have clarified somewhat the state powers.[1] Some states have made a strong effort to get out of state firms selling into the state to register and collect tax voluntarily. Indiana reports 4,834 such firms (1979)--but Michigan only 100. New Mexico once found success "encouraging" firms in El Paso to register by stopping their delivery trucks in New Mexico; however, compliance activities are now the normal assignment of the district office in nearby Las Cruces, N.M. Nevada and Kentucky report good success, the latter mainly with Cincinnati stores.

Others report only limited success--Hawaii, Arizona, Virginia, Rhode Island, Massachusetts, Michigan, Illinois, and Utah. The mail order firms will in general not cooperate unless they can be compelled to because they have business situs in the state.

Taxable purchases of business firms from out of state are caught in audit--if and when the firm is audited--and most states enforce the tax against individual customers on items that must be registered--motor vehicles, boats, planes. A few states go beyond this to check on chattel mortgages filed in the state on goods bought out of state, Utah and Illinois on farm equipment, for example. But most states do not attempt to check on individuals returning from other states or buying out of state for delivery in the state. Indiana raises about $250,000 a year from a line on the income tax return asking for reporting of use tax on out of state purchases.

The states differ in their assessment of the seriousness of loss of business and tax revenue from out of state purchases. As a whole, however, these states do not regard the loss as serious; this opinion was expressed in Hawaii, Arizona, New Mexico, Illinois, Rhode Island, and Massachusetts. Nevada expressed the same view, although noting the loss of some business to California when persons shop in that state and have the parcels sent home, and in the town of McDermitt, which straddles the Oregon border (Oregon has no sales tax). Utah likewise does not regard the problem as serious but feels that the "consumer" states as a whole suffer loss of revenue to the "producer" states that apply the tax and then the consumer states give credit for this tax. This is not relevant for the typical wholesale transaction, of course. Utah's main problem has been with farm machinery, purchased tax free in Idaho. Michigan expressed concern about the loss of business in the Toledo area.

All of the states in the sample do some out of state audit work, sending auditors out for a few weeks at a time. In most states these are regular audit staff persons, sent out on a rotating basis. But Virginia has a separate out of state audit staff, 8 persons, in Richmond, for out of state work on all taxes. Only the three large industrial states maintain audit offices outside of the state. Indiana has 38 persons, assigned to 5 out of state offices. Michigan has 8 persons in 5 offices, and additional teams of auditors are sent to assist them. Illinois has two out of state offices, with a third being added this year. The out of state offices are typically in California, Texas, Chicago, and the New York area.

V. MUNICIPAL SALES TAXES

Of the sample states, none have authorized local sales taxes that did not do so in 1970, but in Georgia and New Mexico, additional authorization was given, in the former to counties in 1976, the power previously limited to the Atlanta transit system, and local sales taxes have spread rapidly in those two states. New Mexico, which once had numerous local sales taxes but merged them into the state levy in 1969, has moved back to substantial local use. The implication is that once the state opens the way to local sales taxes and some start, others follow very quickly.

State Administration. Of this group, Arizona alone allows local administration of the taxes, but, in 1973 legislation allowed the local governments to contract for state administration, and 50 of the 59 cities (compared to 32 in 1971) using the tax, mostly smaller ones, have done so. But the larger cities, Phoenix and its suburbs, Tucson, and Flagstaff, continue to administer their own, convinced that they do a more effective audit job than the state does.

In Illinois, the new constitution of 1970, giving substantial home rule powers to the local governments, allows them to impose sales taxes in any manner they wish and to administer them--in addition to the state administered tax. Thusfar, so far as is known (and the State Revenue Department has no information) none have done so. This possibility constitutes a major backward step in the state-local tax structure and administration.

Charge for State Collection. Five states charge for administering the taxes, Illinois and Utah 2%; New Mexico, 1.2% (of a possible 3%); Georgia and Nevada, 1%. It is interesting to note that free collection in Arizona has not led the larger cities to abandon their own administration.

Local Jurisdiction Involved and Distribution of Revenue. In Arizona the tax is a city levy only; the counties have no power to levy the taxes and play no role whatever.

In all of the other states both counties and cities are involved in the taxes. In New Mexico the county and city levies are quite independent and both apply in the relevant jurisdictions--but few counties have the tax. Virginia cities and counties act independently.

By contrast, in Nevada and Utah, the counties must act first; the cities cannot act independently to impose the tax. In Georgia, the county, or if it does not act, the largest city, may act. This has occurred in one instance, Macon. In Illinois the cities and counties can act independently; but the county tax applies only in unincorporated areas; the levies do not overlap. In fact the city levies came first. With both a city and county levy, the county levy applies in only the unincorporated areas in Illinois and Utah. In Georgia and Nevada (if their is more than one incorporated city), the revenue is shared on a population basis among the various local units. Thus scarcely any two states follow exactly the same pattern.

In Utah and Georgia, provision is made for an additional levy for transit districts: MARTA in Georgia (Atlanta area), the three-county transit system in the Salt Lake-Ogden area plus Park City.

Extent of Coverage. In contrast to the limited coverage in New Mexico and Georgia in 1970, the coverage is complete--or almost so in most: complete in Virginia; all counties and most cities in Utah; all except three small counties in Nevada; virtually complete in Illinois, much of Georgia and Arizona, and much of New Mexico.

Rates. In these states, the highest rate is in Tucson, 2%; the remainder of the Arizona cities use 1%, the rate also found in Illinois, Virginia, and in Georgia, except in the Atlanta metropolitan area, with an additional 1% for the transit district. The combined rate in New Mexico can equal 1%, ranging from 0 to $\frac{1}{4}$, $\frac{1}{2}$, 3/4 and 1. The county levy is $\frac{1}{4}$%, while the cities have the choice of three successive $\frac{1}{4}$% rates. The Utah rate is 3/4, with an additional $\frac{1}{4}$ for the transit district. The Nevada figure is $\frac{1}{2}$%.

Voter Approval. Voters must approve the tax in Georgia, and approval is obtained in about 80% of the elections, and the second and third $\frac{1}{4}$% for municipalities in New Mexico as well as for the county $\frac{1}{4}$%, but not in the other states.

Coverage. All of the taxes have the same base as the state levy except in Arizona, in which Tucson exempts food, while the state and other jurisdictions do not, and some cities still tax apartment rentals although the state has discontinued doing so.

Jurisdiction of Liability. Liability for the tax in most of the states is determined by the locality of vendor, by far the simplest. But Georgia places liability on the basis of place of delivery, and Nevada where the vendor reports the local tax. Contract work is typically allocated on the basis of where the work is performed. Where there is a local use tax on purchases

from out of state, as found in all of the states except Illinois, New Mexico and some of the Arizona cities, place of delivery determines liability. In Virginia, where the tax cannot be allocated by place of delivery, it is distributed on the basis of the same percentage as the tax on sales. There are no local use taxes on intrastate sales in any of these states.

VI. OTHER FEATURES OF THE TAXES

A few other features can be noted briefly.

Vendor Compensation. Six states continue to avoid it; but Indiana added compensation at 3/4%, 1% as of 1980,and none abandoned it. The figures remain the same: 2% in Nevada on the basic levy, 2%; ½% on the additional 1% state levy, and ½% on the local levy; 2% in Kentucky on the first $1000 of tax, then 1¼%; 2% in Illinois; 3% in Virginia and Georgia; a flat $50 in Michigan; plus a flat first $500 of sales in Kentucky.

Costs of Collection. With increased functionalization in operation, it is difficult to get satisfactory figures of sales tax collection costs. Arizona reports a figure of only .4 percent; Nevada, 1.68%, Rhode Island, .6%, New Mexico, .96%.

Direct Pay Permits. These are allowed in Kentucky (80, largely manufacturers), Indiana, about 300, Michigan 20 to 40, primarily manufacturers; 1 in Nevada; a few in Illinois, mainly drug stores, several in Virginia and Massachusetts, (manufacturers and utilities), a few contractors on Federal projects in Utah; in general not permitted in the others.

Small Sales and Excess Collections. The vendors owe tax on sales below the first bracket figure in all states except Indiana where they can be removed by formula. This problem has been lessened by inflation. Amounts collected in excess of the figure obtained by multiplying the tax rate by the gross sales must be paid in Arizona, Nevada, Utah, and Rhode Island, and are checked in audit.

Cash vs. Sales. Only Illinois requires the cash basis except with permission (though many firms use sales); Hawaii, Arizona, New Mexico and Michigan allow the taxpayer the choice; in Kentucky the base used for federal income tax must be employed. The others require the sales (including installment sales) basis.

Other. Hawaii, Arizona, and New Mexico, with their vendor type taxes, do not specify brackets for collection; the others do.

Rhode Island has eliminated (except for a few stores) the formula reporting system for supermarkets and other stores selling food, the pattern long developed by California.

CONCLUSIONS

Survey of the sales tax structures and operation in the 13 states of the sample suggests that no drastic changes have occurred over the last decade. There is a definite but slow narrowing of the scope of the taxes through additional exemptions, of food and drugs and utility services, and of some producers goods as well. There has been no tendency to increase the coverage of services. The tax rates have changed little, with a slight upward trend. Local taxes have expanded in the two states that broadened local powers to enact sales taxes; no other states have added the power and the other states that had the levy had almost complete coverage before 1970 anyway.

There is no significant evidence that administration of the taxes has greatly improved, over the last decade. The greatest change has been the trend--itself slow--toward third generation computers allowing on line direct access to data of the accounts, but less than half the states in the sample have progressed this far. Improved computerization has allowed the speeding up of delinquency control. But the percentage of vendors not filing on time

has not fallen significantly, though a few states have shown definite improvement. There has been a continuing trend to place the smaller firms on a return interval longer than monthly, a step that computerization greatly facilitates.

Audit coverage has shown no substantial change, a few states improving coverage, others lessening it, although in a few instances the latter action was deliberate, in the belief that existing coverage was unnecessarily great. The decline primarily occurred where the number of accounts rose sharply and the number of auditors did not. For most states the present coverage is even less adequate than it was a decade ago, and this is well recognized by most sales tax administrators. There has been little progress in EDP selection of accounts for audit, although Illinois uses the computer to ascertain the larger and thus most productive accounts for audit, and Michigan, a pioneer, has backed away from it. There has been a definite trend toward functionalization of revenue departments and integration of sales and income tax audit, but this is by no means complete.

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