Comments on

Donald Bruce, William F. Fox, and Alannah M. Shute, "Wayfair: A Step Towards the Destination, But Sales Tax Competition Remains"

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This interesting paper provides a very helpful introduction to the changing US sales-tax landscape and presents intriguing new evidence regarding the impact of the landmark 2018 Supreme Court ruling in *South Dakota v. Wayfair*, which reversed a long-standing limit on the ability of states and local governments to collect sales taxes on the purchases by their residents from remote out-of-state vendors. Prior to *Wayfair*, there had been a general sense that state sales taxes would become less and less viable with the growth in remote sales. Post-*Wayfair*, this pessimism has perhaps been lifted, but state and local sales taxes remain very imperfect representations of the ideal destination-based consumption tax. As the paper discusses, sales tax bases have been declining over the years, reflecting both active and passive policy choices – carving out large categories of consumption to be exempt from tax, and failing to include in the tax base the growing share of services in overall consumption. The *Wayfair decision*, in itself, had no direct implications for these policies, as it applied to goods that governments already were attempting to tax. But it could have other, indirect effects, several of which this paper considers. It also might have effects beyond those treated in the paper, an issue to which I will return after reviewing what the paper does cover.

Strictly speaking, *Wayfair* did not expand the set of transactions subject to tax. State and local governments restricted from requiring remote vendors to collect sales taxes on residents' purchases typically attempted to impose use taxes on purchasers at the same rate as the sales tax, but these use taxes were typically very hard to enforce and had very low compliance rates, at least for household purchasers. Hence, one can think of the pre-*Wayfair* environment as being one with a zero rate of tax on remote purchases, which gave them a significant advantage over purchases from vendors with a physical presence in the taxing jurisdiction. Post-*Wayfair*, this route to tax avoidance was sharply curtailed, remaining only to the extent that vendors fall below taxpaying size thresholds or simply evade collecting the taxes now due. That leads to a number of predictions from the authors, including:

1. An increase in sales tax collections, reflecting an effective expansion of the sales tax base to include remote sales;
2. An increase in purchases of tax-exempt commodities, to the extent that these serve as substitutes for the remote purchases now effectively subject to tax;
3. An increase in cross-border shopping in low-tax states, to take advantage of the main remaining way for consumers to lower the sales taxes that they pay;
4. An increase in tax revenues in low-tax border areas, reflecting the switch from remote sales to cross-border shopping;
5. An increase in taxes collected by rural vs. urban locations, as residents of the former, having fewer local shopping opportunities, would be more likely to rely on remote purchases (a phenomenon at least as old as the Sears Catalog);

6. A shift in the location of remote vendors, away from jurisdictions made attractive largely by the pre-*Wayfair* ability to avoid taxes on remote sales; and
7. Possibly other shifts in production activity, occasioned by increased taxes on remote business-to-business sales.

Concerning the last two points, the attractiveness of selling from states with low tax rates, with low populations of consumers subject to tax, or both, was diminished by the taxation of remote sales. But the attractiveness of locating a business in a high-tax state would depend on the profile of the business. Those conducting remote sales might now be more likely to locate in a high-tax state, but those making remote *purchases* might be less likely to do so, to the extent that those purchases had previously been partially untaxed – probably a much smaller issue than the non-taxation of household purchases, but possibly still relevant. This is because, as the authors note, state and local sales taxes typically include a lot of business-to-business sales in their tax bases, providing only spotty exemptions for particular types of purchases (e.g., for immediate resale or as direct inputs into production). The persistence of this defect in the sales-tax model, a standard feature in the United States, is somewhat hard to understand, given the steady shift toward sales apportionment for the corporate income tax. That is, if states have recognized the competitive advantage of shifting taxes away from production and toward consumption, why has this insight not extended to the design of the sales tax? One possible explanation is that states need the money, and lack the political will to expand the sales tax base in other directions. To the extent that *Wayfair* increases the bite of the sales tax on business inputs, this could provide an impetus to reform, but I am skeptical that the impact will be large enough for this reform to happen.

Using data, mostly from Tennessee but also for North Carolina and the country as a whole, Bruce, Fox, and Shute address many of these questions empirically. In doing so, they face several econometric challenges. First, *Wayfair* is a recent decision, and so there are few years of data in the succeeding years, a particular problem if states were slow to adopt conforming legislation. (In Tennessee, we learn, the two relevant pieces of legislation occurred in November 2019 and November 2020.) Second, the *Wayfair* decision affected all states and localities. There is no simple control group against which the *Wayfair* "treatment" can be measured. Finally, the Covid-19 pandemic hit the US economy less than two years after the Supreme Court issued it decision, leaving a short window during which to distinguish the effects of *Wayfair* from the effects of the pandemic, which had very strong effects on the level and patterns of consumer purchases and on the level of business activity.

Recognizing these challenges, the authors look selectively and creatively for patterns consistent with the above predictions. Figure 2 shows a large spike in Tennessee sales tax collections during 2021, which the authors interpret as consistent with prediction 1 listed above. Figure 3 shows a relative increase in rural vs. urban sales tax receipts in 2020. Both of these effects could be due at least in part to the Covid-19 pandemic (a drop in sales in 2020 followed by a rebound in 2021; a less pandemic-impacted economy in rural areas), and the authors consider a shorter pre-Covid sample when moving on to their econometric analysis. In Table 1, we learn that urban areas' revenues grew more slowly than rural revenues after *Wayfair* implementation, even apparently (in unpublished results) for the shorter pre-Covid sample.[1] In Table 2, we see that border areas in North Carolina (a neighboring state with a much lower sales tax rate) had higher sales tax revenues in the post-*Wayfair* period, consistent with increased cross-border shopping. Presumably, at least some of these revenues came at the expense of border areas of Tennessee, confirming the authors' prediction that the *Wayfair* decision could heighten government incentives to engage in tax competition, at least among neighboring states. In Table 3, we see that the *Wayfair* decision had a heterogeneous impact on the level of business applications, with these falling in low-tax states and rising in high-tax states. This is precisely what prediction 6 above would have forecast; e.g., businesses selling to high-tax states would no longer have a tax advantage from locating in a low-tax state.[2]

With more time we will have an opportunity to uncover more results about the effects of the *Wayfair* decision. Of particular interest is how states respond to the new environment in a post-pandemic setting. I have already expressed skepticism that they will be induced to reform their treatment of business-to-business purchases. But, will the apparent response to cross-border shopping incentives lead to lower or more uniform tax rates in border regions? Will the effective increase in their sales tax bases lead states to reduce sales tax rates overall, or will the added revenue show up somewhere else in state budgets? Will states use the extra revenue on offsetting reductions in sales tax bases, or will the higher effective rate on taxed commodities relative to exempt commodities lead to base broadening instead?

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[1] I would have found it interesting to see the "border" and "rate" variables in Table 1 interacted with the post-Wayfair indicator (econ_nexus x border and econ_nexus x rate), to see whether the predictions of increased cross-border shopping and particular revenue improvements in high-tax-rate areas were supported.

[2] I am not sure how this finding squares with the big jump in national business applications in 2020 and 2021 depicted in Figure 5. The latter result could be due to a change in size composition of businesses across states or to Covid-related changes in the business sector, but this is just speculation.

With substantial variation across states in sales tax rates, and (as the authors note) with states in the past appearing willing to change their sales taxes periodically, we have the hope of addressing these and other questions in the coming years, and can appreciate the initial insights and evidence that Bruce, Fox, and Shute have provided to help shape our thinking.