QUARTZ

Collecting sales tax online won't lead to higher taxes—and might lower them

By Tim Fernholz May 7, 2013

Now that the US Senate has passed a law allowing states to collect sales tax on the purchases their citizens make online, sending it to the House, where it may very well die, some myths are spreading about what the bill means. Chief among them is the idea that it will somehow lead to an increase in sales taxes or force people to pay taxes in states where they don't live.

Here's CATO institute fellow Daniel Mitchell:

If politicians in, say, Arizona are worried that consumers will go online or travel across the border to avoid the punitive sales tax, then they should reduce their sales tax rate.

Politicians can choose to maintain uncompetitive tax systems, of course, but they also should be prepared to accept the consequences. I don't think California and Illinois should try to become the France and Greece of America, but that's something for the voters of those states to figure out for themselves.

In any event, they shouldn't have the right to force out-of-state sellers to act as deputy tax collection officials if they decide to impose bad tax policy…Let's limit the power of state governments so they can only screw up things inside their own borders.

First things first, it's important to understand that state governments can still only screw things up inside their own borders: The only sales tax that will hit consumers is the one their elected local and state governments have set in place. If you don't live in California or Illinois, you don't pay their sales tax.

The only thing that changes in other states is that online sellers will need to collect that sales tax, something most businesses already do. Now, it just gets more complicated, and while the law is taking steps to streamline that process, it's understandable that some businesses, like eBay, aren't thrilled about complying with the new rules. Other companies that already collect sales tax, from Wal-Mart to Amazon to Target, favor the new law, in part because they have the infrastructure to manage compliance already.

But what about state tax policy?

The thrust of Mitchell's argument is that anything that allows consumers to avoid sales tax, whether leaving state borders or going online, is a good thing, since it creates an incentive for state governments to lower tax. By denying them the ability to escape online, the logic goes, states will now be able to raise their rates even higher.

But what if the opposite is true? Beginning to collect sales tax online will feel like a tax increase to most people, even though it isn't. That will make them more cognizant of the tax, and more likely to complain to elected officials about reducing the rate—or move to states where the sales tax is lower.

Put simply: The bill doesn't end competition between the states over who has the most business friendly tax policy. It just closes a loophole that makes that competition less effective.