

# THE ACCURACY OF STATE SALES TAX CHARGES ON SELECTED CONSUMER ITEMS

## Report Highlights

The Pennsylvania sales and use tax, which is charged at a rate of 6.0 percent, generated \$7.0 billion in FY 1999-00. The Department of Revenue's Bureau of Business Trust Fund Taxes is responsible for administering the sales tax and more than 320,000 sales tax licensees and are also responsible for collecting it. In early 2000, an investigative news reporter found that the state sales tax was not being properly and uniformly applied on several consumer items purchased at a sample of grocery and convenience stores in Northeastern Pennsylvania. The LB&FC subsequently adopted a study to determine if errors of the type found by the news reporter are widespread and what the Department of Revenue is doing to ensure that the sales tax provisions are being properly and uniformly applied.

**LB&FC Test Purchase Methodology.** Between August and October 2000, LB&FC staff made a series of test purchases to spot-check retailer application of state sales tax provisions on both taxable and nontaxable items. During this period, LB&FC staff purchased common consumer items at 100 stores in 23 Pennsylvania counties. These 100 stores included a mix of chain and independent convenience, grocery, and drug stores as well as large mass merchandise retailers. At each location, we purchased up to 16 items, 8 taxable and 8 nontaxable. The eight taxable items included soap, shaving cream, facial tissues, napkins, fruit juice (< 25% juice content), soda, pet food, and baby powder. The eight nontaxable items were toothpaste, dental floss, toilet tissue, wet wipes, iced tea, bottled water, cough drops, and aspirin.

**Test Purchase Results.** In total, LB&FC staff purchased 1,494 items at the 100 stores visited. Based on these test purchases, we found an overall error rate of 13.6 percent. For taxable items the error rate was 14.4 percent, meaning that for 14.4 percent of the taxable items we purchased, retailers failed to charge sales tax when they should have done so (on 107 out of 741 items). For nontaxable items, the error rate was 12.7 percent. This means that in 12.7 percent of our purchases of nontaxable items, retailers charged sales tax on items on which no tax should have been charged (on 96 of 753 items). The following further describes the test purchase results:

1. On a percentage basis, convenience stores had the highest overall error rate (17.8 percent) of the four store types in the sample. Grocery stores had the lowest error rate (10.2 percent).
2. Error rates for chain stores were much lower than the error rates found at independent stores. For example, the overall sales tax error rate on taxable items at chain stores was 6.2 percent versus 28.3 percent on the same items at independent stores.
3. The relatively low error rate for chain stores as a group may be due in large part to the widespread use of scanning devices in these stores. Stores with scanning devices had error rates of only 8.4 percent

compared to 24.3 percent in stores without such equipment.

4. The most frequent errors made during the test were evident on purchases made at independently operated convenience and drug stores. Independent drug stores made errors on 43.0 percent of the taxable items we purchased. Two of these independent drug stores failed to charge sales tax on any of the taxable items we purchased at these locations. In another case, an independent grocery store charged us sales tax on all the nontaxable items we purchased.
5. Among taxable items, errors were made most often in not charging tax on soap, tissues, and fruit juice. Wet wipes and iced tea were the nontaxable items on which sales tax errors were most prevalent.
6. For all 1,494 items purchased, there was a net overcharge to the consumer of \$0.47.

**Sales Tax Monitorship/Enforcement.** The Department of Revenue acknowledges that errors in sales tax application occur and are a concern. We found that the Department has made a concerted effort to establish systems and procedures to promote retailer and consumer education, handle inquiries and complaints regarding sales taxation, and enforce and audit the sales tax provisions. While enhancements in these systems are certainly possible, this study did not find major shortcomings in these areas.

**Study Conclusion.** Ideally, application of the sales tax would occur without error. In actual practice, an error-free system is, of course, not possible. More than 320,000 sales tax licensees apply the tax in millions of transactions. The potential for error is compounded by PA's very complex tax structure, one that is characterized by many exceptions and exemptions. The report supports: (a) a continuation of the Department of Revenue's current efforts to promote and monitor retailer accuracy in applying the sales tax through retailer/consumer education, complaint handling, and enforcement/audit activities; and (b) the Department's plan to monitor the workings of the national "State Streamlined Sales Tax Project" for possible implications for the Commonwealth.