TRANSCRIPTS

TAXING E-COMMERCE: THE LANDSCAPE OF INTERNET TAXATION*

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INTRODUCTION AND OVERVIEW

PETER COBB**

1. INTRODUCTION

Let me quote the distinguished House Majority Leader, Dick Armey, who was recently heard to say, "Anybody who seriously tries to push a 'tax the Internet' proposal in this Congress is going to get run out of town. The American people won't stand for it."[1] One of the things we can talk about for the next hour and a half is, "What does that statement mean?" We know what Mr. Armey means by the "run out of town" part, but what does he mean when he refers to taxing the Internet? That language is floating around political discourse a great deal right now and the answers aren't as obvious as at least some people seem to think they are. My role as the moderator of this discussion is to give some very high level—stratosphere level—comments on tax policy and taxation in general. Then I will turn the mi-

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[1] Dick Armey, Press Release, Commission Rejects Net Taxes (Mar. 21, 2000), http://freedom.house.gov/library/technology/pr000321.asp.

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crophone over to the other panelists, whose presentations will be significantly more concrete.

1.1. *Basic Policy Concerns Implicated in the E-Commerce/Tax Debate: Pure Tax Policy Concerns and Non-Tax Policy Concerns*

I want to begin by speaking briefly on the policy issues, drawing more from my experience on Capitol Hill than from my experience as a tax lawyer. There are essentially two kinds of policy uses of the tax law: (1) pure tax policy uses and (2) non-tax policy uses.

1.1.1. *Pure Tax Policy Uses of the Tax System*

Pure tax policy concerns can be summarized by the following four principles. First, the tax system should be fair to those who are subject to it. The concept of fairness might include, among other things, the notion of progressivity, which provides that people pay taxes according to their means or according to the extent to which the tax system is viewed as a charge for the services that the state provides. Issues of fairness are fundamentally political in nature. The second principle is that the tax system should not create inappropriate distortions of the economy; it should as much as possible respect the neutral choices of economic decision-makers. This principle is economic, rather than political, but the distinction is often blurred. The third principle states that taxes should be administered as effectively and efficiently as possible— a principle of essential concern with respect to taxation in the Internet context. The fourth principle holds that taxes should raise some revenue— the proper amount of revenue. This last principle gets overlooked from time to time, even though the chief policy reason for having a tax system is to raise revenue. When Congress passed a battery of rules pushing the Internal Revenue Service ("IRS") to adopt a system of principles and reorganize the income tax system, the IRS omitted "revenue raising" from its list outlining the core values and functions of the income tax system. At the end of the day, our various governmental agencies provide services that cost money and are funded through taxes, plain and simple.

1.1.2. *Non-Tax Policy Use of the Tax System— Tax Expenditures*

There are also two non-tax policy ways in which people use the tax system. One is through tax expenditures, which represent the forgoing of tax revenues in pursuit of some other industrial policy or social goal, such as promoting the sale of clothing in New York City de-

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partment stores. A lot of the debate over taxing the Internet, or at least some of the rhetoric, is phrased in terms of tax expenditures. We should be using the tax system to encourage the growth of this important sector of the economy, say the proponents of such expenditures. My own opinion, which was formed after spending time in the legislative process, is that tax expenditures are the primary reason why the tax law is complicated; tax expenditures also explain why tax lawyers and accountants make a very good living.

Tax penalties fall at the opposite end of the spectrum. The power to tax is the power to destroy. If Congress decides that American executives are getting paid too much, they levy an excise tax on salaries exceeding one million dollars. The rhetoric about the Internet and taxation is often couched in "power to destroy" language; opponents of Internet taxation tend to speak of an Internet tax as a punitive act deliberately designed to discourage or punish people who conduct trade over the Internet rather than through catalogues and telephone orders.

1.2. *Taxation and the Internet: An Overview*

If you were asked to discuss taxation with respect to e-commerce, you would find an unbelievable number of topics and issues to raise, including the following: (1) the problems of consumption taxes on the U.S. sales and use tax model; (2) the problems of consumption taxes on the Value Added Tax ("VAT") model; (3) the problems of income taxes on the international and national levels; (4) the problems of income taxes on the sub-national level; and (5) the problems of collection and enforcement. The remainder of my discussion will touch on those five issues, which are based on four different tax systems along with the issue of enforcement.

The most interesting problems regarding an income tax on the Internet arise in connection with business income taxes, and not individual income taxes. Of equal importance is the problem of creating an income tax regime suited to the complex global environment. The individual income tax issues raised in that arena tend to fall more solidly in category five, which addresses problems of collection and enforcement.

We'll probably spend most of our energy today talking about consumption taxes of the sales and use types. When we speak of such taxes, we are referring to ordinary state and local sales taxes. The chief characteristic of the ordinary sales tax, from a policy standpoint, is that it is, at least in theory, a tax whose economic burden is borne

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by the consumer. In the case of the U.S. sales and use tax as applied by the states, it is a tax on retail sales only— the final transaction before consumption— and therefore it is only a business-to-consumer tax; it does not directly implicate business-to-business transactions. It is designed as a consumption tax; it is expected to be borne by the consumer. Again, we're talking about individuals; there are no strong issues of fairness or jurisdiction in terms of collecting the tax itself. Underlying the sales tax is a use tax, which means the state, in order to pay for services it provides to residents and occasional visitors, is taxing individuals on their consumption of goods or services within the state. It doesn't raise particular issues of fairness or anything else for the state to attempt to do that, regardless of the sources of the transaction.

If there were an efficient way of collecting the use tax, a lot of the issues that are being hotly debated would not arise. The issues arise because the only effective way, until recently, to collect the use tax was to put the burden of collection on the seller instead of the buyer. Therefore, with an increasing volume of out-of-state sales, whether it's through catalogue sales, Internet sales, or telephone sales, there is increasingly a need to collect this tax from businesses located outside the state.

If there is a lack of neutrality in the way that tax is applied, then there is an economic inefficiency. For example, if as a New York resident you don't have to pay the eight percent sales tax on Amazon.com but you do for Barnes and Noble, you're choosing Amazon.com not only because they deliver books more efficiently, but because they are selling books at what amounts to a discount of eight percent. Several policy implications flow from that arrangement. First, Barnes and Noble hates it— as they should— on grounds of fairness in business. Second, it is no longer a consumption tax; it becomes a tax on businesses in the position of Barnes and Noble, which are going to have to match Amazon.com's prices; that additional eight percent consumers save in taxes is going to come out of the so-called bricks-and-mortar businesses' pockets simply because the playing field is not level.

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1.3. Consumption Taxes of the Sales and Use Type[2]

The real debate and the legitimate debate in this area can be reduced to two competing viewpoints. From the state's point of view, there is a potential for erosion of the base. As the volume of taxable consumption within the state goes down, the net revenue to state and local governments overall goes down. A recent study conducted by the State of California shows that the concern is not over the present, but the future. From the businesses' point of view, there are two basic concerns. One is from the bricks and mortar businesses, the Barnes and Nobles of the world, which are acutely aware that they are at a competitive disadvantage vis-à-vis their counterparts on the Internet. The Internet companies, by contrast, are worried that an enormous administrative burden will be placed upon them, at a moment when there are over seven thousand state and local taxing jurisdictions, each with different rules and rates of taxation. I'm told by reliable sources that the software to deal with that—if the laws didn't keep changing—would not be terribly hard to put in place and credit card companies would be quite capable of administering it if they so desired. But the scheme would not come without substantial costs. The law changes rapidly. And there is the administrative problem of figuring out where people live. So that's what the real debate between the major players is, with the Main Street businesses on the side cheering the state taxing authorities.

1.4. Consumption Taxes of the VAT Type

The VAT is also a consumption tax. The United States is the only country in the developed world that does not have a VAT at this point. The problems of a VAT regime are somewhat different from the problems of a U.S.-style tax scheme. A VAT is a consumption tax

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[2] The author placed the following information on an overhead projector:

(i) The taxing authorities are primarily concerned about base erosion;

(ii) California Statistics: 1999-2000 fiscal year revenues from sales tax will be over $32 billion, amounting to one-third of the State's general fund revenue;

(iii) Between now and 2003, retail e-commerce will grow from 33% to 800% of catalogue sales and from 1-2% of total retail sales to 15%;

(iv) As a matter of good tax policy, the only real argument against imposing a sales tax collection obligation on Internet vendors is the administrative burden; and

(v) There are over 7000 different jurisdictions in this country, each with its own classification rules and rates.

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that is designed to be borne by the ultimate consumer, but it is also collected at every stage of the production manufacturing chain of delivery; therefore, it is imposed on business-to-business transactions as well as business-to-consumer transactions. In a VAT regime, with transactions whose chain of delivery crosses boundaries, a very complicated set of issues is raised as to who collects the tax, who has to remit tax funds, and how the tax should be designed such that the country where the ultimate consumer lives will collect all of the tax and not just the tax on the final sale. Coordinating such a system in a rational manner is, well, taxing to say the least. Because the VAT operates in the rest of the world where the economies are much more interactive than they are in the United States, definitional issues arise concerning how particular transactions should be taxed and whether those transactions should be subject to tax in light of all of the new ways of delivering goods and new kinds of businesses produced. It is no surprise that VAT-related issues presently account for a large share of the negotiations among the European States.

1.5. Income Taxes— Federal and International

Income taxes raise more complicated conceptual issues than alternative tax schemes do. Many of these issues are unrelated to the Internet or e-commerce per se, but they are tightly connected to economic globalization, particularly when the taxation of enterprises, rather than individuals, is in play. In a global economy, it is difficult to identify where a specific residence is located and what primary jurisdiction should levy an income tax. The ideal international tax system— at least from a tax policy point of view— is one that taxes every item of income once and allocates the income fairly among the jurisdictions in which the people who possess that income, whether businesses or individuals, enjoy the services provided by those jurisdictions. For that system to work, everyone has to agree on what constitutes income, when to tax it, and how to coordinate those issues on an international basis.

1.6. Income Taxes— Sub-national

Most of our states and some of our localities have an income tax system in place, and many of the same issues that arise on the Federal level appear at the local level. There is one crucial distinction between taxation on the international level and on the sub-national level that is worth pointing out: sovereign nations allocate tax revenues among themselves on transactions across borders. In the international arena,

the allocation of revenue among competing jurisdictions is completed through a very complicated series of tax treaties, through a system of taxing people based on residency and their source of income, or a complicated set of tax credits that seek to harmonize the previous two bases. Discontinuities in these laws exist and are easily exploited by the tax lawyers and investment bankers, who are highly compensated for finding loopholes.

In the United States, with respect to the state and local tax system, the approach to apportioning income is very different from the approach used in the international context, partly because the states and municipalities are all part of the same country and must adhere to the same federal constitution that obligates people to do certain things. The state and local tax systems in the United States—and this is an idealized version of it—tend to define income on a national level and then allocate it to the several states (this state gets this much while that state gets that much) according to the degree to which their activities are related to each of those states. It's an apportioning approach rather than a more complicated give and take treaty approach. It's actually much more efficient; it's administered through a multi-state tax commission, which has had some significant ability to make the various rules coherent. The apportionment method does have the impact that the stakes of being found to have a nexus with a particular state of the United States for income tax purposes are not as high necessarily, at least if the system is working right, as being found to have a nexus with a foreign country with a high tax rate. In the international arena, if you're found to have a nexus there, they may tax everything, in which case you'll have to figure out how to get something back from these complicated rules. In the state system, if your minimal contacts are sufficient to enable the state to tax you, those minimal contacts will work through the apportionment and you will most likely have to file a return. If your contacts are truly minimal, your actual tax burden will be small from the very beginning.

1.7. *Compliance and Enforcement*

To finish up, the final arena is compliance and enforcement. These are the principal concerns about the way in which the Internet and globalization affect the income taxation of individuals in particular. Because there are increased opportunities to engage in money-making activities offshore, such as gambling and investing, the Internet, in effect, creates opportunities for the so-called "black market economy" to be accessed much more easily than it was in the past.

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The other side of that equation reveals that the Internet— along with developments of software— gives the taxman a set of tools that is much more powerful in obtaining information than anything that's been used in the past. The tech-knife cuts both ways.

TAXING INTERNET TRANSACTIONS

STEPHEN J. KOBRIN*

1. INTRODUCTION

In 1996, John Perry Barlow declared cyberspace independent of all "Governments of the Industrial World," asking them to "leave us alone."[1] While the tone differs considerably, the Clinton Administration's "Framework for Global Electronic Commerce"[3] also calls for government to stay out of cyberspace wherever possible: for private sector leadership, reliance on market forces and the avoidance of undue regulation. Needless to say, "leave us alone" is a very common e-business industry response to government regulation.

The mantra of those involved in e-commerce seems to be, "If you tax us you will kill us," implying that any attempt at taxation (or regulation) will plunge society back into the age of dial telephones, if not carrier pigeons. There is also a belief that the technology of the Internet and e-commerce is moving too fast for government to keep up with it, that any attempt at taxation or regulation is doomed to failure. The Internet is seen as a private, entrepreneurial space beyond the reach of public authorities, and public policy, except in the most dire of circumstances— such as a threat to those actually involved in e-commerce.

It is important to recall that the Internet did not arise spontaneously out of the ether as a result of the efforts of millions of disconnected entrepreneurs. The Internet was created by the Advanced Research Projects Agency ("ARPA") of the U.S. Defense Department in

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[1] John Perry Barlow, *A Declaration of the Independence of Cyberspace*, *at* http://www.eff.org/ ~barlow/Declaration-Final.html (last modified Feb. 8, 1996).

[3] William J. Clinton and Albert Gore, Jr. *A Framework for Global Electronic Commerce*, http://www.iitf.nist.gov/eleccomm/ecomm.htm (last visited Oct. 18, 2000).

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the 1960s and 1970s as ARPANET. The Internet was not privatized until the late 1980s, and the last wave of privatization was not completed until 1995. The Internet— regardless of what it looks like now— was a public good, delivered by government, with public funding.

The Internet, and more generally the information revolution and the digital age, raises some fundamental questions for society that cannot and should not be resolved by the "Netizens"— the denizens of Cyberspace— alone. For example, the scope of private versus public space (both name-linked data and personal privacy in general), the meaning of intellectual property and how creative efforts will be rewarded, and taxation will all face fundamental change as a result of the digital revolution and the Internet.

Privacy is at risk. Video pattern recognition (the matching of camera images with databases of faces), cell phones, satellite navigation devices, automatic turnpike toll systems (e.g., E-Z Pass) and the collection of vast amounts of personal information on the Internet will dramatically redefine the meaning of privacy and private space. It is far from clear that anyone knows what intellectual property will mean in the digital age or what it will mean to be an author or composer or how to reward creativity. A Stephen King book was made available on the Internet and distributed electronically for two dollars and fifty cents— it sold four hundred thousand copies in the first week.[4] However, the site was quickly hacked; the book was made available in Postscript Document Format ("PDF") on a Swiss website. Similarly, music is widely distributed through sites such as Napster[5] and Gnutella.[6]

Privacy and intellectual property are examples of important social issues that affect a much broader range of people than those currently involved with the Internet or e-commerce. They will both be affected dramatically by the digital age in ways that are still very hard to foresee. They must be dealt with by society at large as social issues and not decided by those inhabiting cyberspace in isolation.

Taxation and our tax structure will also be changed fundamentally by the Internet and the spread of e-commerce. It is obvious that taxation is a major social (and political-economic) issue. The difference between the United States and many European countries, for ex-

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[4] *See* David D. Kirkpatrick, *King E-novel Short of Expected Demand*, N.Y. TIMES, July 25, 2000, at C8.

[5] http://www.napster.com.

[6] http://www.gnutella.com.

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ample, is not a six percent sales tax versus a fifteen percent value added tax. Differences involve more basic preferences for direct or indirect taxation, beliefs about the role of government and needs for government revenue, equity and redistribution, and social policy in general. The critical questions entail how and why we collect taxes, from whom do we collect them, and what we do with them.

Changes in the organization of politics and the economy affect taxes and the tax structure directly. The proportion of total tax revenue in the United States accounted for by corporate taxes, for example, has shrunk dramatically as a result of a number of changes associated with the globalization of enterprise. The growth of the Internet and e-commerce will impact the tax structure even more dramatically and raises fundamental questions, certainly including whether government revenues will remain adequate. Will we end up taxing only property that is nailed down, absolutely fixed in terms of specific geographic coordinates? Will the burden of sales taxes, and perhaps even income taxes, shift to people who are too poor or do not have the capability to get wired? What about wealth distribution, the digital divide, and the progressive tax structure? Will revenues be sufficient to support military expenditures, education, big science, medicine, and the like?

Privacy, intellectual property, and taxation— all critical social issues that will be changed fundamentally by the digital revolution— are much too important to be left to the Netizens. While change is inevitable, the parameters of that change must be established by society at large. There is a well-known quote from Marx about technological determinants. Marx said that the hand mill gave us the feudal lord, and the steel mill the industrial capitalist. Does the Internet have to give us a regulation and tax-free space?

Marx took a very hard view of technological determinism, one maintaining that technology is a basic force shaping the structure of society and that there is little to be done about that. I do not think we have to buy that argument lock, stock, and barrel. The massive technological revolution brought on by the information revolution certainly sets parameters and shapes society. However, there is still a lot of room for societal choice; there are many decisions that can be made by a broad democratic process: how far should we let the technology go, how fast should we let it expand, and should we attempt to ameliorate or accelerate some of its effects?

It is perfectly reasonable to argue for massive tax reductions or for a libertarian view of regulation. However, one should not clothe these

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arguments in a mantle of bits and bytes: the Internet and e-commerce should not be a Trojan Horse for socio-economic philosophies.

The Internet is a revolutionary technology; society at large, however, still has the responsibility and authority to make decisions about the social issues. To bring the matter back to taxation, the question that should be asked is, "What is the reason for not taxing the Internet?" To be clear, I am talking about taxation of transactions and income generated in cyberspace, not "bit" taxes or taxes on various aspects of the Internet, per se. When Internet entrepreneurs say that they cannot survive if they are taxed, the question to ask is, "Why should they survive?" What are the social reasons for a tax subsidy of e-commerce? The reasons may well exist, but the argument should be presented directly and stand on its own merits.

2. DIGITAL TRANSACTIONS

While e-businesses like Amazon.com[7] or CD-Now[8] represent a dramatic change in the nature of retailing, in many ways the change is much less revolutionary than would appear at first glance. While Amazon.com has changed the nature of the book business, and while I personally find value in their website, the basic transaction is much the same as their sending me a catalogue and my sending a postal card in return with my order information. Regardless of whether my order is placed electronically or by mail, the delivery is the same. A book is a book and it often arrives in a heavy package via UPS. Someone carries it the last mile to its destination.

But, does a book have to be a book? As in the example of Stephen King's novella discussed above, it can take the form of bytes downloaded over the Internet. Software, especially updates, are routinely downloaded as is a great deal of music, as the current turmoil over peer-to-peer systems such as Napster and Gnutella demonstrates.

When the bits that are downloaded are paid for with bits— in the form of digital or electronic cash— the transaction begins to get interesting. While digital cash has not been widely adopted, the technology is available. Using public key encryption technology, it is possible for digital or electronic cash to be both anonymous and secure: that is, the receiving computer knows that the cash is valid without having to know the identity of the sender. (Whether or not digital cash should

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[7] http://www.amazon.com.

[8] http://www.cdnow.com.

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be anonymous is controversial, with law enforcement agencies on one side of the argument and privacy advocates on the other.)

Thus, completely digital transactions are a possibility and will become a reality. There will be transactions where all that moves in either direction are zeros and ones. Given sufficient bandwith, movies, books, music, photographs, and even medical or legal advice will flow in one direction and digital cash in the other.

That raises the critical issue of geographic jurisdiction. Under the modern or post-Westphalian international system, economic (and political) governance is grounded in territorial sovereignty. Taxation and regulation are a function of geographic jurisdiction: we ask "where" questions. *Where did the transaction take place? Where did the income stream arise? Where is the company located?* The questions apply to transaction taxes (sales or VAT) and to income taxes, whether source or residence based.

The problem is that "where" questions become very problematic—both in practice and conceptually—when dealing with "all-digital" transactions, which will grow dramatically in importance over the next couple of years. Two brief examples will illustrate some of the problems.

The Indian software industry has expanded exponentially over the last ten years. It is an export-oriented industry, and close to half of Indian software exports take place either through satellites or over the Internet. It is very common for a programmer in Bangalore, India, for example, to be working in real time on a bank's computer in New York City, upgrading the system, fixing a bug, or installing new software. If the Indian programmer in Bangalore upgrades a system in New York, she clearly adds economic value: an economically valuable transaction has unquestionably occurred.

Where does the transaction take place? In which jurisdiction? What happens if the programmer is using a laptop in Nepal and the bank's server in New York is actually linked directly to a back office computer in New Jersey or Ireland? What does geography mean? Where did the transaction take place?

Imagine a Wharton MBA student traveling to London to interview with an investment bank for a summer job. He takes his laptop with him and while waiting for his delayed flight to leave from Kennedy Airport, downloads music through the Penn server from a French firm whose server is linked to one in India, and then pays for the transaction using electronic cash, perhaps a smart card from a bank in Toronto. He rushes to make the flight and plays the music

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during the trip across the Atlantic. Where did the transaction take place? Which jurisdiction gets to collect sales or VAT tax: Pennsylvania, New York, France, or perhaps Iceland?

There are two issues. One is a matter of enforcement: how will any jurisdiction know the transaction took place, much less where the buyer and seller "are?" How does any government that is involved track an all-digital transaction? There is no audit trail (assuming the digital cash is anonymous) and nothing is delivered.

More important, perhaps, is the conceptual issue. Geography simply does not map on cyberspace. The reality is that the transaction did not take place in any geographic location. As noted above, the basic assumption underlying economic governance in the modern era is that, regardless of how international the world economy, any transaction can be located precisely in two dimensional geographic space. At least in theory, the transaction will fall within someone's jurisdiction. (That is not to say that you cannot have jurisdictional conflict and overlap.)

E-commerce, and especially digital transactions, renders the notion that transactions can be located unambiguously in a particular jurisdiction somewhat absurd. In a very real sense, a digital transaction may not fall within anyone's jurisdiction: there is no there, there. Geography does not map on cyberspace. The question is how tax authorities deal with the problem.

Interestingly, both the Organization for Economic Cooperation and Development (the "OECD") and the U.S. Commission on Internet Taxation threw up their hands concluding that digital transactions can not, and thus should not, be taxed. I do not believe that to be a reasonable or practical response. As more transactions migrate to the Internet, and as more physical goods are replaced by zeros and ones, the authorities are not going to be able to plead "no contest."

3. WHOSE RULES APPLY?

Ultimately, the issue comes down to whose rule, whose tax law, and whose tax jurisdiction applies. The problem is complicated by the fact that in addition to being non-geographical— or perhaps more correctly a-geographical— the Internet is inherently transnational. Both the Administration's "Framework for Global Electronic Commerce"[9] and OECD reports on topic assume directly that the Internet is global.

[9] Clinton et al., *supra* note 3.

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Any website anywhere can be accessed by any computer located anyplace on the Internet. Draconian measures aside, it is extremely difficult to prevent information from flowing across borders – in fact the idea of fixed borders is almost meaningless in the context of a network. A website offering a new software program for a Palm Pilot, for example, that is "located" in Ohio, can be accessed as easily in Athens or Ankara as in Akron.

A recent OECD report[10] on Internet taxation argues that transaction tax should be applied where consumption takes place. However, a parenthesis follows that reads "the place of consumption is yet to be defined." It is far from clear that the location "where" a transaction takes place is a meaningful concept in cyberspace: the problem transcends enforcement, geographic jurisdiction may be conceptually irrelevant in this context.

In discussions of Internet taxation (the OECD reports on the subject, for example) one finds a number of assumptions or principles stated. First, taxation should be economically neutral; it should not influence the location or form of economic activity. Second, and especially with reference to the Internet, is the avoidance of either no taxation or double or triple taxation. The two extremes appear were a transaction falls between jurisdictions or is taxed by multiple jurisdictions. Third is an equitable distribution of tax revenue. The last principle deals with maintaining fiscal sovereignty based on geographically defined national markets and nation states.

The problem, at least to my mind, is that all of these principles may not be achievable simultaneously. It may be difficult to avoid either not taxing or double taxing, or to distribute revenues equitably, while maintaining fiscal sovereignty. Given the inherently non-geographic and transnational nature of the Internet and cyberspace, it may be impossible to resolve "jurisdictional" issues, distribute revenue, or even collect sufficient revenues to sustain governmental activities while maintaining the practice or principle of mutually exclusive jurisdiction—political and economic control exercised through control over geography. In the digital age, effective, efficient, and just tax systems may require substantive international cooperation.

It is important to consider all of this in some historical perspective. The question of sovereignty and territorial jurisdiction was not relevant in medieval Europe. In the pre-modern period, territorial

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[10] COMMITTEE ON FISCAL AFFAIRS, DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, OECD, ELECTRONIC TAXATION FRAMEWORK CONDITIONS (1998).

sovereignty, the idea of a singular political authority grounded in mutually exclusive geography, was not relevant. I am not at all certain that it will continue to be meaningful in the post-modern, digital global economy. We forget how new the word "international" is. The word was first used by Jeremy Bentham in 1780 in a discussion about jurisprudence. Prior to that time, the distinction between the domestic and the international was not very meaningful. If that distinction, and the idea of geographic jurisdiction, become less meaningful in the future, what are the alternatives?

4. ALTERNATIVES

For purposes of discussion I would like to focus on transaction taxes: sales and value added taxes. Again, the problem posed by e-commerce, and especially all digital transactions, is that it is far from simple to use geographic jurisdiction as a basis for determining and collecting taxes. It is difficult to track transactions and it may be impossible to locate either sellers or buyers precisely in geographic space. The problem is both practical and conceptual: geography does not map on cyberspace. Furthermore, the Internet and as a result, e-commerce, are inherently transnational.

As an aside, collecting sales taxes on Internet transactions within the United States for goods that are delivered physically may be a matter of political will. In most instances, buyers owe a use tax on a purchase from an out-of-state seller, whether the transaction takes place by mail or the Internet. The problem is that absent a nexus in the state, the sellers are not required to collect the tax and, in the vast majority of instances, buyers do not pay it.

The reason for not requiring sellers to collect sales tax on out-of-state transactions is that it would impose an undue hardship on conducting interstate business. While that may have been true in the past, it surely is not at this point. A desktop computer can easily be programmed to reflect the tax rules of domestic jurisdictions— whether there are ten or twenty thousand— and given the buyer's zip code there is no reason that the seller or a third party (credit card companies have been suggested) could not remit the correct tax to the appropriate jurisdiction. Again, the issue is one of political will in an era when the only question on the table seems to be the size of a tax reduction.

As noted above, I believe that in the long run dealing with the taxation of transactions on the Internet will require international ef-

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forts. I will mention a number of possibilities, but will not explore any in depth.

The simplest alternative would seem to be agreement that transactions be taxed in either the seller or buyer's jurisdiction. While that might eliminate the possibility of double taxation or no taxation, it raises a number of problems. If it is the seller's jurisdiction, would there be a race on the part of e-business to tax havens? Such an alternative still assumes that jurisdiction is meaningful—which is very questionable in this context.

Another alternative is the harmonization of national legislation. National transaction tax codes could be modified so that their impact converges: so that sales or VAT taxes would be locationally neutral. While that is certainly a possibility, it would be extremely difficult to achieve because of the vast cultural, philosophical, and social differences across countries.

A multilateral treaty is possible for international taxation, but raises many of the issues discussed above. I believe that at the end of the day there will be a need for an international tax authority with the power and ability to collect and distribute revenues. That may be the only way around the jurisdictional issue. However, it is impossible at this point to imagine the U.S. Congress giving sovereign taxing authority to any international organization when simply paying U.N. dues appears impossible.

On the other hand, if nothing is done about taxing e-commerce transactions, at some point in the future governments' revenue streams will be reduced to a level that does not support even minimal public spending. It may take that sort of a crisis to motivate necessary international cooperation to begin to solve this problem.

ADVISORY COMMISSION ON ELECTRONIC COMMERCE: ACTIVITIES AND FINDINGS

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1. INTRODUCTION

This afternoon I am going to provide an update on the recent activities of the Advisory Commission on Electronic Commerce (the "Commission").

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The Commission is authorized to study the international, federal, and state and local taxation of transactions using the Internet and Internet access and other comparable intrastate, interstate, or international sales activities. Congress established the Commission in 1998. The Commission's nineteen members include three representatives from the federal government, eight representatives from state and local government, and eight representatives from the private sector.

The Commission's report is due on April 21, 2000.[11] Any findings and recommendations included in the report require the approval of two-thirds of the members.

The federal representatives are:

- Andrew Pincus, General Counsel, U.S. Department of Commerce;
- Joseph Guttentag, Senior Advisor, Office of Tax Policy, U.S. Treasury; and
- Robert Novick, General Counsel, Office of the United States Trade Representative.

The state and local government representatives [were]:

- James Gilmore, Governor, Commonwealth of Virginia;
- Dean Andal, Chairman, California Franchise Tax Board;
- Paul Harris Sr., Delegate, Virginia House of Delegates;
- Ron Kirk, Mayor, City of Dallas;
- Mike Leavitt, Governor, State of Texas;
- Gary Locke, Governor, State of Washington;
- Gene Lebrun, former President, National Conference of Commissioners on Uniform Laws; and
- Delna Jones, County Commissioner, Washington County, Oregon.

The private sector representatives are:

- C. Michael Armstrong, Chairman & CEO, AT&T;
- Grover Norquist, President, Americans for Tax Reform;
- Richard Parsons, President, Time Warner, Inc.;

[11] Advisory Commission on Electronic Commerce, Report to Congress (Apr. 2000), http://www.ecommercecommission.org/acec/_report.pdf.

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- Robert Pittman, President & COO, America Online, Inc.;
- David Pottruck, President & co-CEO, Charles Schwab Corporation;
- John Sidgmore, Vice Chairman, MCI WorldCom and Chairman, UUNET;
- Stan Sokul, Independent Consultant, Association for Interactive Media; and
- Theodore Waitt, Chairman, Gateway, Inc.The majority and minority leaders of the House and Senate appointed the non-federal representatives on the Commission. The White House appointed the federal representatives.

2. ACTIVITIES AND FINDINGS OF THE ADVISORY COMMISSION

The Commission adopted a draft report on March 30, 2000. The report includes three recommendations that were approved by the required two-thirds vote. Other Commission proposals received the support of eleven members, two votes short of a two-thirds majority. The final report, however, will include all the proposals of the Commission, including those that were approved by a bare majority vote. The controversial decision to include all of the proposals was made by the Commission's Chairman, James Gilmore, after the Commission's parliamentarian ruled that the Commission could include them in the report sent to Congress.

2.1. Recommendations

The recommendations, approved by a two-thirds vote, were not particularly controversial and engendered very little debate. These recommendations did not address the tough tax policy issues raised by the Internet. Rather, the Commission simply recommended that Congress:

- Clarify federal welfare guidelines to expressly permit the states to spend Temporary Assistance for Needy Families ("TANF") program surpluses to provide needy families access to computers and the Internet and to provide training in computers and Internet use;
- Explore the privacy issues involved in the collection and administration of taxes on e-commerce; and
- Support a permanent "standstill" on tariffs imposed on the Internet.

2.2. *Majority Proposals*

Other proposals that received support of eleven of the nineteen members of the Commission address many of the more controversial tax policy issues raised by Internet taxation. A majority of the Commission recommended that Congress:

- Extend the current moratorium barring multiple and discriminatory taxes through October 21, 2006;
- Extend permanently the current moratorium on taxes imposed on Internet access charges;
- Repeal taxes imposed on Internet access charges that are grandfathered under the current moratorium;
- Exempt digital goods (and their tangible property equivalents) from sales and use taxation for five years;
- Encourage state and local governments to work together to simplify sales and use tax laws;
- Encourage state and local governments to work together to simplify state and local telecommunications taxes;
- Create another commission to report on simplification efforts and to consider whether enhanced collection obligations would be unreasonably burdensome on interstate commerce; and
- Eliminate the 3% excise tax on telecommunications services.

In addition, a majority of the Commission proposed that Congress explicitly provide that certain "factors" "would not, in and of themselves, establish a seller's physical presence in a state for purposes of determining whether a seller has sufficient nexus with that state to impose collection obligations [sales and use taxes]." These factors are:

- A seller's use of an Internet service provider that has physical presence in a state;
- The placement of a seller's digital data on a server located in that particular state;
- A seller's use of telecommunications services provided by a telecommunications provider that has a physical presence in that state;
- A seller's ownership of intangible property that is used or is present in that state;
- The presence of a seller's customers in a state;
- A seller's affiliation with another taxpayer that has physical presence in that state;

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- The performance of repair or warranty services with respect to property sold by a seller that does not otherwise have a physical presence in that state;
- A contractual relationship between a seller and another party located within that state that permits goods or products purchased through the seller's website or catalogue to be returned to the other party's physical location within that state; or
- The advertisement of a seller's business location, telephone number, and website address.

A majority of the Commission further proposed that Congress explicitly provide that certain "factors" may not be taken into account in determining "whether a seller has sufficient nexus with a state to be required" to pay business activity and income taxes in that state. These factors are the same as those proposed for sales and use taxes, and, in addition, provide that a seller's sales and use tax registration with a state and/or a seller's collection and remittance of use taxes for a state, will not be taken into account in determining whether the seller has nexus with that state for purposes of business activity and income taxes.

Finally, a majority of the Commission supported additional proposals relating to international taxation. A majority of the Commission members proposed: (i) supporting the permanent extension of the World Trade Organization's current moratorium on international tariffs and duties imposed on electronic transmissions, (ii) recognizing the leadership role of the OECD in coordinating an international dialogue concerning the taxation of e-commerce, and (iii) supporting the OECD's framework conditions for taxation of e-commerce.

2.3. *Next Steps*

The Republican congressional leadership has expressed its approval of the Commission's report, including those proposals that were supported only by a majority of the members. Legislation implementing the report is unlikely this year, but lobbying has already begun and will continue into next year. The Presidential candidates have so far been cautious in their public comments on Internet taxation. Regardless of what happens to the Commission's proposals, the states are currently working on developing model sales and use tax legislation that would simplify and harmonize state sales tax laws. This model legislation is slated for consideration by state legislatures in early 2001.

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