COMPUTER AND TECHNOLOGY LAW CONFERENCE
Software, Networks and E-Commerce

Berkeley Center for Law & Technology and
The University of Texas School of Law

June 29, 2001
San Francisco, California

E-COMMERCE: TO TAX OR NOT TO TAX? THAT IS THE QUESTION … OR IS IT?

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INTRODUCTION

For the past several years, we have heard some policymakers talk about not taxing the Internet so that it, along with e-commerce, can grow unencumbered by taxes. We have also heard talk, primarily from state and local government officials and some businesses, that the Internet and e-commerce need to be taxed in order to protect government revenues and to "level" the playing field among all types of businesses and taxpayers. In 1998, we saw the federal government enact the Internet Tax Freedom Act (P.L. 105-277) providing a 3-year moratorium on certain taxes.[1] California, as well as a few other states, also enacted Internet Tax Freedom Acts. In addition, much study and discussion has taken place and continues among governments and businesses to understand the application of existing tax rules and systems to the new business model of e-commerce and to new types of transactions and assets presented by the operation of the Internet. These discussions have been at the international, national, state and local levels.

Despite all of the discussion so far, significant issues remain within the topic of taxation of the Internet and e-commerce. We continue to see misstatements from policymakers and journalists about the issue, which highlight the difficulty of the subject matter and serve to prolong the confusion. The e-commerce taxation debate does not seem to be one of Republicans versus Democrats, but more one of sales tax dependent jurisdictions versus jurisdictions less affected by a small loss of such revenues (for example, compare the statements below of two Republicans - Governor Geringer of Wyoming and Lieutenant Governor Swift of Massachusetts). It is also a debate where most economists and tax practitioners argue that taxation makes economic and business sense, while some politicians with an anti-tax platform have adopted e-commerce as a focal point for their arguments. However, even among those who argue that e-commerce is commerce and should be taxed, the ideas for how to effectively tax it are diverse. One thing is certain, it is a fascinating debate and will likely continue for years. In fact, some of this current debate had its roots in longstanding tax issues, such as collection of use tax[2] on mail order sales, sourcing of income, and characterization of revenues from software transactions. Arguably, the Internet has just highlighted these and other longstanding tax issues, and created a few new ones. Perhaps the Internet and e-commerce serve as a "wake-up call" that it is time to improve and update our existing tax systems as we pick up the pace in moving from the industrial era to the information age.

Approach of this Article: This article begins with a description of the tax versus don't tax debate. A sampling of statements made in various forums and the results of various studies are provided to give an overview to the focus and tone of the debate. Next, a policy framework provided by the AICPA[3] is used to address the broad question of this article – "should the Internet be taxed?" Appendices to this article provide background on (A) how various features of the Internet and e-commerce create tax issues, (B) examples of projects undertaken to address e-commerce taxation issues, and (C) "myths" and "realities" of e-commerce taxation.

THE E-COMMERCE TAXATION DEBATE

What's Been Said

The statements provided below were selected as representative of numerous statements made in the past five years regarding taxation of the Internet and e-commerce. While they could have been summarized rather than left in original text, a better sense of the debate can be gathered from the actual quotes. The relevance of these statements to defining the debate is explained in the next section of this article.

1. Congressman Christopher Cox (co-author of the Internet Tax Freedom Act) in a speech delivered to the National League of Cities on March 13, 2000 (excerpts):[4]

i. “Our ultimate goal should be to provide simplicity and certainty in the imposition of local taxes and questions of interstate tax liability. It’s in everybody’s best interest to do that. It’s in the best interest of a Main Street business or a rural family that wants to set up operations on the Internet because it will give them access to a global marketplace. It’s in the best interest of any Internet user because people who use the Internet want to know that their products and services are not subject to multiple, discriminatory, or special taxes. And it’s in the best interest of tax collectors because tax collectors need clear rules about what kinds of transactions are and are not subject to tax, and who is going to collect that tax.”

ii. “[T]he express aim of the Internet Tax Freedom Act is the neutral tax treatment of all economic activity, whether it’s e-commerce or whether it’s commerce conducted by any other means. The law is aimed only at ensuring that the Internet is not subject to discrimination, that it is not singled out for special taxes that don’t apply in the offline world.”

iii. “Some news reports have erroneously blamed the Internet Tax Freedom Act for the inability of cities and states to collect sales or use taxes from remote sellers. As you know, those restrictions on collecting taxes from remote sellers were imposed in two Supreme Court decisions, not by the Internet Tax Freedom Act.”[5]

iv. “A streamlined tax collection system is necessary as a pre-condition under the terms of the Supreme Court’s language if the Court is ever going to change its decision in the *Quill* case. … A streamlined system … is vitally important because it’s in the best interests of taxpayers, businesses, and cities and states. But there is yet another reason it’s very important to simplify. And that is that if we don’t, as I said, Congress is going to come up with ill-advised proposals for a federal Internet sales tax.”

2. Senator Bob Smith upon introduction of S. 328 (106th Congress): “a tax on Internet shopping is really just another tax on the American consumer. American consumers already pay taxes on their salaries, taxes on their capital gains, property taxes on their homes, taxes on the goods they purchase from instate vendors, and estate taxes on any property they have managed to save by the time of their death. Imposing yet another layer of taxes in cyberspace is simply unfair, especially because many Internet shoppers already pay shipping or handling costs in addition to the purchase price of the goods they buy.”[6]

3. Governor Jim Geringer in testimony before the Senate Commerce, Science and Transportation Committee on March 14, 2001:[7]

i. “The hearing notice on your Committee’s web page indicated that the purpose of this hearing is ‘whether Congress should *allow* states to require all remote sellers to collect and remit sales taxes on deliveries into that state, provided that states and localities dramatically simplify their sales and use tax systems.’ I suggest Mr. Chairman, that the issue is not whether the Congress should *allow* states and local governing bodies, but whether the Congress should *enable* such actions. The answer is ‘yes.”

ii. “Congress, the states and local governments need to function in the new economy without hindering its continuing expansion.”

iii. “[T]he Congress should not dictate an absolute pre-emption of state prerogatives on tax issues. You can and should enable the states to come up with their own approach that will lead to uniformity.”

iv. "While states have been precluded from taxing electronic transactions, the federal government imposes many federal taxes on Internet transactions or businesses, including excise taxes as well as individual and corporate income taxes. The airline ticket tax increase was a critical part of the Balanced Budget Act of 1997, a tax that was increased again last year. No member offered an amendment to exempt from those federal taxes, domestic or international tickets purchased on the Internet, perhaps because such an exemption would have accelerated the migration of ticket purchases to the Internet. That might have eroded a critical source of revenues to the Airport and Airway Trust Fund. … Do consumers have to pay a federal excise tax when buying tires, airline tickets, liquor or cigarettes over the Internet? Should we propose federal legislation to not tax the income of any person or corporation which makes its money over the Internet as an incentive to boost Internet activity?"

v. "Not collecting the use tax on electronic transactions would be an incentive for merchants to use electronic or Internet transactions. States are concerned that Congress' actions or inaction could lead to accelerating the erosion of sales and use tax revenues as the nature of the retail industry evolves."

4. Lieutenant Governor Jane Swift in testimony before the Senate Commerce, Science and Transportation Committee on March 14, 2001:[8]

i. "I am deeply concerned that a tax on the Internet will serve to hinder growth in this important sector at the time when it can least afford it. The proper role of Government in this emerging industry is to encourage its growth. It would be a grave mistake on our part to start taxing Internet commerce before it has even had a chance to establish itself."

ii. "We have found that the positive effects of high technology sectors have far outweighed any perceived detriment to local retailers or to state sales tax revenues. These firms have rejuvenated crumbling cities, and have provided high-qualify, high-paying jobs to thousands. This is the kind of economic activity we need to develop across the country, and I fail to see how taxing that activity will provide the needed encouragement. I am especially skeptical of the need for increased taxes at a time when state revenues have been reaching record highs. I believe now is the time to lower the tax burden on our citizens."

iii. "I also question the wisdom of plans that are as complex as that proposed by the NGA. The complexity of these interstate sales taxes is something that the government should not be undertaking. With all due respect to my colleagues, I am not certain that establishing a large bureaucracy to deal with online sales taxes is what this country needs. It seems to me that one IRS is enough for Washington. We don't need a second."

5. Peter Lowy, CEO Westfield America and Founding Chairman of the e-Fairness Coalition in testimony before the Senate Commerce, Science and Transportation Committee on March 14, 2001:[9]

i. "[T]he government should not provide preferential sales tax treatment based solely upon the distribution system used to sell goods. Requiring brick and mortar retailers to collect sales taxes while exempting their online competitors is fundamentally unfair, and presents a glaring national problem that requires Congressional action."

ii. Price competition has caused many brick-and-mortar retailers to create separate subsidiaries to operate online sales. The online store, when set up as a separate legal entity, is only required to collect sales tax from customers in states where the online store has a physical presence. Mr. Lowy noted that K-Mart's online store only has to collect sales tax in

California and Ohio, Barnesandnoble.com only in New Jersey, Nevada, New York, Tennessee and Virginia, and Wal-Mart.com only in Arkansas, California, Ohio and Utah.

iii. "[R]emote retailers – that is Internet and catalog retailers – should be subject to the same sales tax collection responsibilities as traditional or Main Street retailers, if the states are successful in simplifying their sales tax systems."

6. Governor Gray Davis of California upon vetoing AB 2412 (2000): "In order for the Internet to reach its full potential as a marketing medium and job creator it must be given time to mature. At present, it is less than 10 years old. Imposing sales taxes on Internet transactions at this point in its young life would send the wrong signal about California's international role as the incubator of the dot-com community."[10]

7. National Tax Association (NTA) Report of September 1999: "The Project could not, however, agree on a definition of telecommunications. … Without an agreement on the definition, the Project found it impossible to make progress on the broader issues of state and local telecommunications tax reform."[11]

8. *A European Initiative in Electronic Commerce* (April 1997): "To allow electronic commerce to develop, it is vital for tax systems to provide legal certainty (so that tax obligations are clear, transparent and predictable), and tax neutrality (so there is no extra burden on these new activities as compared to more traditional commerce). The potential speed, untraceability and anonymity of electronic transactions may also create new possibilities for tax avoidance and evasion. These need to be addressed in order to safeguard the revenue interests of governments and to prevent market distortions. … [T]he goal is threefold: to provide legal certainty, to avoid undue revenue losses, and to ensure neutrality."[12]

What's Been Measured

Various studies have been done privately and by governments to identify the costs to government of the inability to collect sales and use tax on many e-commerce sales, and the costs to businesses of collecting sales and use taxes. Such studies have focused on sales and telecommunications taxes and not income taxes due to the far greater complexity involved in complying with sales and telecommunications taxes. Surveys have also been performed to gauge consumer reaction to paying taxes on Internet commerce. Some of the findings are summarized below.

1. Uncollected Sales and Use Tax (private studies): A June 1999 study concluded that 63% of business-to-consumer online sales were non-taxable (such as airline tickets, gambling, and interactive games). Of the remaining 37% of business-to-consumer sales, sales tax was paid on 4% (4% of the 100% of business-to-consumer sales), and 20% was a substitute for other remote sales for which no tax was collected, leaving 13% of total business-consumer sales untaxed. The study applied an average state and local sales tax rate of 6.5% to determine that the estimated sales tax loss was $170 million for 1998, representing one-tenth of 1% of total state and local sales tax collections.[13]

   A May 1999 study by Professors Austan Goolsbee and Jonathan Zittrain estimated that for 1998, sales tax loss to state and local governments related to e-commerce sales was less than one-quarter of one percent (about $210 million). Assuming a projected 70% per year growth in e-commerce retail sales would yield a revenue loss of under 2% in 2003. The authors of the study note that to keep revenue constant, the average sales tax rate on sales would have to increase only from 6.33% to 6.35% in 1998 and 6.4% in 2003. However, the authors also note that by 2007, the revenue loss would equal about 10% of total sales tax revenue. "It is the possibility of these extreme losses, albeit well into the future, that makes the issue of enforcement so politically sensitive today."[14]

2. Uncollected Sales and Use Tax (government studies): A June 2000 General Accounting Office (GAO) study estimated that the state and local sales and use tax losses for all Internet sales for 2000 was between $0.3 and $3.8 billion (about 2% of projected sales tax revenue). This included both business-to-business and business-to-consumer Internet sales. The projected loss for 2003 was between $1.0 and $12.4 billion (5% of projected sales tax revenue). The differences between the high and low figures is due to varying assumptions as to business-to-business compliance rates and the estimated amount of e-commerce sales.[15]

   In March 1999, the California Board of Equalization estimated that California's annual loss of sales and use tax from e-commerce was about $18.5 million.[16] The June 2000 GAO study projected sales and use tax losses in California from all Internet sales for 2000 as between $23 and $533 million. The GAO's projection of lost revenue for 2003 was between $86 and $1,720 million.[17]

3. Consumer Reaction to Tax on Internet Transactions: A September 1999 survey conducted by @plan and Gallup found that 58% of respondents taxing online purchases would hurt the overall growth of the Internet.[18]

   A study by Professor Austan Goolsbee found that the number of online buyers could drop by 24% if sales tax were applied to Internet commerce.[19]

4. Cost of the ITFA Moratorium and its Possible Expansion*:* The federal Internet Tax Freedom Act (ITFA, P.L. 105-277, 10/21/98) imposes a 3-year moratorium (from 10/1/98 through 10/21/2001) on state and local taxes on Internet access, unless such tax was generally imposed and actually enforced before October 1, 1998. S. 288 (107th Congress) proposes both to extend the moratorium, and to remove the grandfather provision so that no state or local government could tax Internet access fees. It has been estimated that such a change would cost Texas about $50 million annually and Tennessee about $17 million annually.[20] Tax Analysts estimates that repeal of the grandfather provision would cost the nine states that are covered about $90 million in the first year.[21]

   A bill similar to S. 288 was passed by the House – H.R. 3709 (106th Congress) in May 2000. The Congressional Budget Office (CBO) released a "mandates statement" explaining that H.R. 3709 posed a problem under the Unfunded Mandates Reform Act. "Because at least one significant state revenue source – taxes on internet access – would clearly be affected and others might be affected, CBO estimates that the extension and expansion of the moratorium would cause revenue losses that would exceed the annual statutory threshold at some point over the five-year period." Due to the difficulty of estimating the potential revenue loss if with the absence of the ITFA, states decided to impose taxes on Internet access, the CBO calculated its estimate using only the states covered by the ITFA's grandfather provision. The CBO also noted: "In addition, by extending the current moratorium, the bill may affect the ability of state and local governments to collect certain other taxes. Significant and continuous change within the industry, as well as uncertainty about possible legal interpretations of these definitions, make it impossible for CBO to predict the likelihood or magnitude of such effects on state and local budgets."[22]

5. The Complexity of Multistate Sales Tax Compliance: A state's ability to impose use tax collection responsibility on a vendor only exists when that vendor has a physical presence in the state. Several years ago, the U.S. Supreme Court found that with 6,000+ jurisdictions[23] in the U.S. able to impose sales and use taxes, it would be an impediment to interstate commerce to cause an out-of-state vendor to collect use tax.[24]

   For companies that do have collection responsibilities due to a physical presence in most, if not all, of the 46 states imposing a sales tax, compliance costs can be very high. A multistate company will need to hire several individuals to satisfy its compliance obligations, acquire software to assist in the process (which requires at least monthly updates), and to keep up with changes in the law in each

state in which it does business. Large companies with many physical locations must budget the resources to comply with all of these tax systems. However, the Internet allows a company to have customers in many different locations while having very few physical locations. It also allows new companies to operate in many states without needing any capital for physical (bricks and mortar) expansion. Such new and small companies would likely be put out of business or not seek the market potential presented by the Internet, if faced with obligations to collect use tax from customers in 6,000+ jurisdictions.

Complexity, with its resultant compliance costs, also stems from the multitude of changes in state and local sales and use tax systems annually. For example, a provider of sales and use tax compliance software reported 598 instances in which changes were made to sales tax rates or that new sales taxes were added during 1999. This was an increase from 579 such changes in 1998, but less than the 707 changes that occurred in 1994.[25]

The task of reducing the existing complexities for multistate vendors are challenging because in some states, such as Colorado, cities define the tax base, which could (and does) differ from the state tax base. Also, local tax rates are not always bound by zip codes. Instead, some zip codes could include more than one local tax rate. In addition, definitions of items (such as handling costs) differs from state to state, as do exemptions from the tax. In addition, tax forms and due dates, as well as audit procedures vary from state to state.[26]

6. The Costs of Sales Tax Compliance: The costs to comply with the tax rules of multiple taxing jurisdictions can be quite high in terms of labor costs, training, computer systems, need for continual updates due changes in laws and regulations, audits, credit card fees, and risk of error. A 1998 study by the State of Washington on sales tax compliance costs reached the following conclusions:[27]

Costs as a percent of total state and local sales tax collections:

Small business	6.47%	(gross sales between $150,000 and $400,000)
Medium business	3.35%	(gross sales between $400,000 and $1,500,000)
Large business	0.97%	(gross sales over $1,500,000)
Total cost weighted by number	4.23%	
Total cost weighted by dollars	1.42%	

The costs of compliance can also be complicated and costly due to the frequent changes to tax rules and forms. While many companies rely on software systems for compliance, such systems can be expensive to obtain and maintain. Also, many large companies may find that they need to create their own software systems rather than purchase canned programs.

A 1999 study by Ernst & Young LLP concluded that the costs of administering state and local sales taxes were primarily borne by vendors. The report notes that a large remote seller in 15 states has compliance costs of about 8.3% of the sales and use taxes paid. It was also noted that e-commerce vendors would face additional costs over traditional vendors. For example, there would be added costs of collecting information about the buyer's location.[28]

7. Costs of Telecommunication Tax Compliance: The Committee on State Taxation (COST)[29] has studied the complexity of federal, state and local telecommunications taxes in terms of compliance and tax liabilities. COST's initial 1999 study compared the burden of telecommunications taxes with other business taxes. In January 2001, COST issued an update to the 1999 study. The 2000 COST study found that the nationwide average effective rate of transaction taxes for sales of telecommunications services was 17.74% compared to the average effective rate on sales of goods of 6%. In addition, filing obligations in the states and local jurisdictions totaled 63,879 returns for telecommunications taxes compared to 8,951 returns for sellers of goods. Telecommunications

companies have 350 types of taxes imposed upon them by state and local jurisdictions, compared to 117 for general businesses. The study also found that only 13 states have an exemption for communications equipment while 36 states have an exemption or reduced rate for manufacturing equipment[30]

Defining the Debate – What the Statements and Measures Mean

The statements and data provided above indicate that the e-commerce taxation debate is mostly focused on the sales and use tax and the application of taxes to Internet access fees. Concerns over multiple taxation, complexity for multistate vendors, loss of government revenue, and a level-playing field for taxpayers are key elements of the taxation debate. Despite the focus on sales and telecommunications taxes, issues also exist with respect to federal and state income taxes and international taxation.

The debate includes both technical and policy issues. The policy issues run the spectrum from whether on-line sales should be subject to sales tax, to who (Congress or the individual states) should decide what should or should not be taxed. Technical issues include how to simplify tax systems, how to source sales (to the seller's location or the buyer's location), and how tax compliance and administration can be streamlined.

Given the main topic of this article – "to tax or not to tax?" and that this question does not seem to be resolved yet based on the statements listed earlier, an attempt is made in the next section to answer this question, incorporating the statements and data above to clarify the policy issues raised.

SHOULD INTERNET COMMERCE BE TAXED?

In March 2001, the AICPA issued a statement—*Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*. The framework provides 10 principles, as described below in the context of answering the question: Should Internet commerce be subject to tax? The framework recognizes that it is not always possible to incorporate all ten principles into tax systems – that some balancing is needed.

1. "Equity and Fairness – Similarly situated taxpayers should be taxed similarly."

   Vendors selling goods and services online should be treated similarly to "Main Street" vendors selling the same goods and services and vice versa. While the cost of the sales and use tax is actually imposed on the buyer, rather than the seller, the compliance burden and price competition presented by the sales tax makes this a significant tax to vendors. Certainly, the compliance costs of the sales tax is greater for vendors with customers and taxable presence (nexus) in many states because of the varying sales tax rules among states and even some cities. But, is a multistate vendor similarly situated to a "Main Street" vendor with a single location? For example, assume vendors are required to collect sales tax from all customers, even in states where the vendor has no physical presence. A Main Street retailer with a store in San Jose would have much lower compliance costs than an online vendor also located only in San Jose, but who sells to customers in all states. The online vendor would need to determine where all of its customers live and charge the applicable sales tax (in contrast, under today's sales tax law, the Main Street vendor is allowed to just charge the San Jose rate to all customers that come into the store).

   Thus, arguments of "leveling the playing field" must consider the added compliance burden placed upon vendors required to collect tax based on the location of their buyers. While the prices charged by the multistate vendor and Main Street retailer would be the same if both are required to collect sales tax, the playing field is not level if the online vendor has greater compliance costs. Equity and fairness between Main Street and online vendors require some balancing of the compliance costs, as well as the sales tax charged. This could be achieved by 1) requiring the Main Street retailer to charge

sales tax based on where its customers live, 2) allowing the online vendor to charge San Jose/California sales tax to all customers regardless of where they live (origin approach), 3) providing some compensation to the online vendor for the extra compliance costs, or 4) providing a mechanism, such as a third party collector funded by the government, to handle the online vendor's compliance activities.

Telecommunication taxes may also fail to satisfy the equity principle, primarily due to merger of industries and layering of taxes. Today, an Internet Service Provider may be providing telephony and content, but not be subject to the same range of telecommunications taxes as a phone or cable company might be subject to. This is a challenging issue as illustrated by the fact that the NTA study group was unable to even agree on a definition of telecommunications for tax purposes. This is an area in need of analysis with a focus on equity and simplicity.

2. "Certainty – The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined."

   Lack of certainty in the tax system reduces the confidence taxpayers have that they have computed their tax liability correctly. Today, with over 6,000 jurisdictions able to assess sales tax and a lack of uniformity in the rules of these jurisdictions, as well as frequent changes to the rules, uncertainty exists for multistate vendors. Improvement is needed by streamlining the rules among jurisdictions or replacing the individual state and local sales tax with a federal level tax.

3. "Convenience of Payment – A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer."

   This principle is mostly met with today's sales tax rules, which tend to require periodic filing and payment at a time subsequent to the sale.

4. "Economy in Collection – The costs to collect a tax should be kept to a minimum for both the government and taxpayers."

   The costs to taxpayers of complying with both sales and telecommunications taxes are quite significant for multistate vendors due to the large number of taxing jurisdictions and lack of uniformity in the rules.

5. "Simplicity – The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner."

   For multistate vendors, both sales and telecommunications taxes fail to satisfy the simplicity principle. The multiple definitions, rules, registration procedures, exemptions, rates, filing and audit procedures result in a great deal of complexity. Improvements to simplify the sales tax system include uniformity of rules and procedures, better use of technology to compute and collect the tax, use of a third party to compute and remit the tax, or perhaps a federal level tax to replace the state sales tax.

6. “Neutrality – The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.”

   As evidenced by the earlier statements, the sales tax law is not neutral with respect to e-commerce for either vendors or customers. Sales tax has played a part in location and form of operation decisions for some vendors. For example, the founder of Amazon.com has stated that he purposely did not locate the company in California because he expected to have many customers there and did not want to have to charge sales tax.[31] Also, as noted in the testimony of Peter Lowy for the e-Fairness Coalition, some brick-and-mortar vendors established separate subsidiaries for their online sales in order to reduce the number of states where the online entity would have a physical presence, and thus, a sales tax collection obligation. Thus, sales tax has played a significant role in taxpayer location and form of operation decisions and is not neutral.

   Also, the current situation where remote (non-present) vendors are not required to collect sales tax can cause sales tax to play a part in a customer’s decision as to how and where to purchase goods and services. For example, a customer may decide to purchase a computer online to avoid sales tax rather than purchase the computer from a Main Street vendor. Also, in a few states, such as California, software (and other digitized goods) transferred online are not subject to sales tax, while their tangible counterpart (that is, a boxed music CD or software) is subject to sales tax. Thus, the sales tax law is not neutral in that it will play a role in a customer’s decision as to how and where to purchase certain products.

   The sales tax could be made more neutral by requiring sales tax to be charged by remote vendors, enforcing use tax rules (customers making taxable purchases from remote vendors are required to remit use tax on their own, although state enforcement and educational efforts are weak), exempting all digitized items from sales tax along with their tangible counterpart, or taxing all products regardless of how they are transferred.

7. “Economic Growth and Efficiency – The tax system should not impede or reduce the productive capacity of the economy.”

   This is the argument to support not taxing online sales – that doing so will impede growth of the Internet. However, the Internet seems to be growing without any indication that it is due to the current tax rules. For example, the Department of Commerce reported that e-commerce sales increased 33.5% in first quarter 2001 over the first quarter of 2000.[32] In early 1998, prior to the enactment of the ITFA, it was reported that the number of Internet hosts was growing at a rate of 40% to 50% annually.[33] While some studies have found that taxation of online shopping will reduce online shopping, the issue isn’t really so simple as to argue that taxes should be avoided. Today, online purchases are subject to sales and use tax in all states that impose a sales tax. However, the ability of states to collect use tax on remote online sales is quite low. Also, will imposition of taxes eliminate the sale, or just more it from the Internet to Main Street? Or, will Internet vendors find some way to reduce costs to help “compensate” for the added costs of both shipping and sales tax?

8. “Transparency and Visibility – Taxpayers should know that a tax exists and how and when it is imposed upon them and others.”

   Sales and use taxes are visible because they are shown on the customer’s invoice. Even invoices prepared at Internet sites will show any sales tax charged. However, many consumers may not know that a sales tax exists on particular transactions. For example, many consumers who are not charged

sales tax on online sales likely believe it is due to the ITFA when it is most likely due to the *Quill* decision. Also, customers likely don't know all that the sales tax applies to – for example, will it apply to "free" items obtained from online vendors? Does it apply to shipping charges?

Telecommunications taxes are unlikely to meet the transparency and visibility principle due to the fact that there are so many different types of taxes imposed by the federal, state and local governments. The cost is often buried within the consumer's bill. Thus, this principle is not satisfied for telecommunications taxes.

9. "Minimum Tax Gap – A tax should be structured to minimize non-compliance."

   The use tax causes a tax gap because so few consumers (and even some businesses) know what a use tax is or that it exists to complement the sales tax. While some states have made efforts to inform residents about the use tax, such as by adding a line on the state personal income tax form for it, as evidenced by the GAO data cited earlier, compliance is very low. Improvement could be made by states educating consumers about the use tax and simplifying compliance, simplifying sales tax systems such that Congress might exercise its authority under the Commerce Clause and allow states to collect use tax from remote vendors, or replacing the sales tax with another type of consumption tax. The Internet not only makes it easier to purchase items from a vendor in another state, but also in another country. While Congress could require a remote vendor to collect a state's sales and use taxes, it will be far more difficult, if not impossible, to get a vendor in a foreign country to collect a state's sales tax. Thus, if the tax is to be collected, states will need to get consumers to voluntarily comply or to exempt foreign sales, which then violates the neutrality principle. An alternative consumption tax to the sales tax would be for consumers to measure their consumption as Income less Savings. Of course, this would also involve extra recordkeeping and it would broaden the tax base over what it is today (it would tax all consumption rather than just tangible personal property).

10. "Appropriate Government Revenues – The tax system should enable the government to determine how much tax revenue will likely be collected and when."

    Today, less than 1% of retail sales are online sales. Thus, lost use tax is still small. It is really the potential growth of e-commerce that poses the greatest use tax loss for state and local governments. This growth will adversely affect the predictability and reliability of governments to determine their expected tax revenues. Also, for the few states, such as California, that do not tax products transferred electronically, as more and more items are transferred in digitized form, there will be a drop in the tax base. To improve the predictability and reliability (as well as stability) of sales tax revenues, improvements are needed to the system now while the revenue losses are relatively small.

CONCLUSION

While the "to tax or not to tax" argument can be answered simply in that e-commerce is commerce and should be taxed like all other commerce, this article has pointed out several of the problems in taxing e-commerce (also see the issues listed in Appendix A). This has mostly been a sales tax issue, as no one has been arguing that income of online vendors be exempt from income tax. Also, no property or telecommunication tax exemptions have been sought (except for Internet access fees). In many ways, e-commerce is just highlighting long-standing issues with the sales tax. The sales tax is a Depression-era tax that worked well in the industrial era where physical items were mostly transferred within state borders. We are now in the information age where borders are not very important, and intangibles and services are a larger part of the GDP than they were years ago. Also, the sales tax is dependent on location

and under the e-commerce model, a company can reach a large customer based with very few physical locations. In addition, the Internet allows for the transfer of what used to be tangible items, in the form of bits and bytes (digitized). Digitized products are not taxable in all states and are had to track. Vendors of digitized products might find that most of their customers say they live in a state without a sales tax and there is no easy way for the vendor to verify the information.

E-commerce can be viewed as presenting an opportunity to modify existing tax systems to address today's business model. There is also a need to consider the global nature of e-commerce with work needed on international tax reform as well. Merger or blurring of industries that involve transfers of digitized items has also called into question the application of telecommunications taxes that may not apply similarly to similar taxpayers today.

Much work is needed so that tax systems can apply to e-commerce and satisfy the 10 principles of good tax policy. This is no small task, but one that needs to be pursued in a collaborative fashion by businesses and governments.

APPENDIX A

WHY THE INTERNET AND E-COMMERCE RAISE TAX ISSUES

E-commerce represents a new business model. As such, it creates some challenges to tax systems that were designed with a different model in mind. Some of the key reasons why e-commerce raises tax issues are explained below.

1. Location: Existing tax systems tend to determine tax consequences based on where the taxpayer is physically located. The e-commerce model enables businesses to operate with very few physical locations. An online vendor can easily sell to customers throughout the world from a single physical location. The e-commerce business model also involves more customized inventories so storage needs (and thus the need for many physical locations) are reduced. Also, the model involves less vertical integration and more outsourcing – again, fewer physical locations are used by a vendor. Also, some business assets, such as servers, are not necessarily tied to a single physical location, but can easily be relocated without any interruption to business operations. That is, the location of the server is not relevant for business purposes and thus, may not be a logical taxing point.

   Location factors primarily raise tax issues at the international and state and local levels, rather than at the federal level. For example, the U.S. Supreme Court has ruled that a state may only require a vendor to collect sales and use tax if the vendor has a physical presence in the state.[34] Also, outsourcing raises issues as to the nature of the relationship between the company and the supplier to determine if the supplier is the company's agent creating a taxable presence (nexus) for the company in the state.

2. Nature of Products: E-commerce allows for some types of products, such as newspapers and music CDs, to be delivered in digitized (intangible) form, rather than in tangible form. Digitized products raise issues at the state level as to whether sales tax applies and in which state income is generated for state income tax purposes. Public Law 86-272, enacted in 1959 prohibits a state from taxing a foreign corporation's net income derived from activities within the state if those activities consist merely of solicitation of orders for the sale of tangible personal property that are approved, filled, and shipped from outside the state. This law is out-of-date today where the transfer of services and intangible items is a significant business activity. The nature of products can also raise income tax issues regarding the type of revenue generated and how it is to be reported, as well as whether digitized products are subject to traditional inventory accounting rules.

3. New Marketing Techniques: The Internet has allowed for new ways of selling and buying goods and services. For example, individuals can offer their unwanted items to a worldwide group of potential buyers via auction sites, such as E-Bay. The Internet can also be used to easily link business buyers and sellers through exchange web sites where buyers post what they have to sell and sellers match up with them, or vice versa. Such sites can almost operate without human intervention for the matching function. In addition, the Internet has increased the use of bartering, most notably with respect to exchange of web banners that serve as advertisements. These new techniques raise various tax issues at all levels. For income tax purposes, issues include whether an exchange intermediary or broker should be accounting for inventory, and what amount of information reporting should be required for low-value bartering transactions, and how such transactions should be valued. At the international level, the source of the income generated (which country) might be uncertain. At the state and local level, issues exist as to when individuals have sold enough goods to be required to become sales tax collectors and how to enforce such rules. Another issue raised by changes or elimination of intermediaries is that some

intermediaries collected excise tax, such as sellers of fishing equipment. When buyers interact directly with a foreign manufacturer, rather than a domestic retailer, the excise tax may go uncollected.

4. New Types of Assets: Some of the new assets created by commercial use of the Internet are domain names (URLs) and web sites. For income tax purposes, issues exist as to how to treat the costs of creating or acquiring such assets, as well as the characterization of any gain or loss generated upon disposition of the asset. Sellers of such assets may face uncertainty in the law as to how to characterize the gain or loss generated from the disposition (capital or ordinary).

5. Remote Workforce: The workforce of an Internet company may be scattered throughout a state or country, rather than working in a single work location together. This can raise issues as to whether the presence of the employee in a particular state creates tax obligations for the employer in that state. Also, cities may find that employers owe business license taxes due to the presence of an employee in the city or that if the worker is not an employee that the worker owes business license taxes.

6. Making Optimal Use of the Internet May Challenge Old Rules: One area where use of the Internet has potentially raised some tax issues involves how some tax-exempt organizations are using the Internet. For example, a tax-exempt organization might allow donors to be listed on the organization's Web site. This may cause the entity to face issues as to whether the listing is merely an acknowledgement or whether it is advertising that may result in unrelated business taxable income (UBTI) for the organization. Another issue may exist where an organization that primarily operates on the web, such as a non-profit information exchange, meets the tax definition of a tax-exempt organization. Also, the Internet may allow for more efficient interactions between a tax-exempt organization and its donors, yet existing rules were not written with such interactions in mind. For example, a receipt is required for certain donations in order for the donor to be entitled to a deduction. Will a receipt generated by and printable from a Web site constitute an appropriate acknowledgement for tax purposes? In October 2000, the Service issued Announcement 2000-84, 2000-42 I.R.B. 385, which lists various issues that tax-exempt organizations may face related to the Internet. The Service asked for input from interested parties as to whether additional guidance is needed for tax-exempt organizations.

7. Nature of Transactions: The Internet allows for paperless transactions and the potential for the use of electronic cash. This raises administrative concerns for the Internal Revenue Service as to whether transactions were properly reported, whether an audit trail exists, and whether new reporting rules are needed. In a speech entitled, "Tax Administration in a Global Era," (former) Treasury Secretary Summers stated:

   > "The Internet provides new ways for tax administrations, such as the IRS, to improve the ease and transparency of tax collection. But new technology also raises certain problems. In a world where cyber-transactions are growing at a rapid pace, tax administrations face the challenge of adapting existing tax systems to an economy that increasingly ignores physical borders.
   >
   > In such a world, it will be easier for companies to avoid tax collectors by operating worldwide through web-sites based in jurisdictions that are unwilling to share taxpayer information."[35]

APPENDIX B

STEPS TAKEN TO ADDRESS E-COMMERCE TAXATION ISSUES

Briefly described below are examples of some of the discussion and actions that have occurred in trying to solve the e-commerce taxation issues explained earlier in this article. For more information about these activities, see the reports and links at:

http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html

The Clinton Administration: In November 1996, the U.S. Treasury Department released a report, *Selected Tax Policy Implications of Global Electronic Commerce*,[36] which led to much broader discussion of issues at the international, national and state levels. The purpose of the Treasury report was to provide an "introduction to certain income tax policy and administration issues presented by developments in communications technology and electronic commerce." The paper does not make any conclusions, but instead raised issues for discussion.

In 1997, the White House released a "framework" on e-commerce covering various legal and operational aspects of global electronic commerce.[37] With respect to taxation and customs issues, the framework provides:

- The U.S. will advocate that the Internet be declared a tariff-free zone when used to deliver products or services.
- No new taxes should be imposed on Internet commerce.
- Taxation of e-commerce should follow current principles of international taxation, should avoid double taxation, and be simple to administer and easy to understand.
- Taxation of e-commerce should not hinder commerce and consist of a system that can accommodate both U.S. tax systems and those of other countries.
- Guidance should be based on existing tax concepts and principles, wherever possible.
- Any tax system applicable to e-commerce must address its special characteristics—possible anonymity of the parties, small transactions, and difficulties of trying to identify non-physical transactions with a physical location.
- The U.S. should work with the OECD to help achieve global consensus on taxation of e-commerce.
- The above principles should be applied not only in the international context, but also at the subnational levels.
- "Before any further action is taken, states and local governments should cooperate to develop a uniform, simple approach to the taxation of electronic commerce, based on existing principles of taxation where feasible."

Foreign Countries and the OECD: The OECD, Australia, Canada, and the European Union have issued extensive reports[38] similar in concept and approach to the U.S. Treasury and White House papers. Common themes include:

- The Internet and e-commerce present opportunities for both governments and businesses.
- New taxes should not be imposed because restricting development of the Internet and e-commerce will only harm the country's economy.
- Neutrality should be considered in applying tax laws to transactions in e-commerce so that the tax law does not distort behavior.
- Multiple taxation must be avoided.

- Tax systems should be simple in order not to hinder a business's expansion of its market into the large markets offered through e-commerce.
- Countries will need to work together to deal with tax issues so as to avoid multiple taxation, undue competition, updating and coordinating treaty provisions, coordinating the legal basis for taxing multinational transactions, and coordinating enforcement powers.
- Governments and taxpayers should work together to identify and address issues.

The OECD has organized conferences of representatives of both businesses and governments to discuss solutions to e-commerce tax issues. The OECD also formed five Technical Advisory Groups (TAGs) to study specific issues. The TAGs include individuals from industry, as well as government officials from developing countries that are not OECD members.

National Tax Association (NTA) Communications and Electronic Commerce Tax Project: This industry-government group was formed in late 1996 to address state and local tax issues of applying subnational taxes to e-commerce, and to reach consensus, possibly in the form of model legislation for states to adopt. The group consisted of 16 people from industry, 16 from government and 7 "other" from universities, the ABA, and the AICPA. Congress had high regard for the NTA's work as indicated by a provision in the ITFA that the Advisory Commission shall "to the extent possible, ensure that its work does not undermine the efforts" of the NTA E-Commerce group. In September 1999, the NTA group issued its final report.[39] This report includes a very important caveat that "Nothing is agreed to until everything is agreed to." Thus, none of the preliminary conclusions are to be considered final conclusions. Some of the significant preliminary recommendations or resolutions adopted, subject to the caveat, include:

- There should be one *rate* per state with some type of measure taken to "ensure protection and equitable distribution of revenues to local jurisdictions."
- States should have the ability to set their own tax *base* (no uniform base should be prescribed for the states).
- Transactions should only be *sourced* to the state level, not to the local level. Sourcing should be on the destination basis. If sourcing information is not available, default rules, to be developed, should be followed.
- State and local sales and use tax *administrative* rules should be simplified. Possible approaches include better use of technology, creating uniform vendor registration and exemption forms.

Federal Advisory Commission on E-Commerce:[40] In addition to establishing a 3-year moratorium on specified state and local taxes, the Internet Tax Freedom Act also called for formation of a 19-member Advisory Commission on Electronic Commerce (ACEC). The members included 8 representatives of state and local governments (including one from a state with no sales tax and one from a state with no income tax), and 8 representatives from the e-commerce industry (including small business), telecommunications carriers, local retail businesses, and consumer groups. The ACEC was to conduct a thorough study of all levels of tax with respect to e-commerce, including considerations of all types of remote commerce, and report to Congress in April 2000. The ACEC report could contain legislative recommendations. Per the legislation that established the ACEC, "any recommendation agreed to by the Commission shall be tax and technologically neutral and apply to all forms of remote commerce. No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission serving at the time the finding or recommendation is made."

In April 2000, the ACEC issued a report describing proposals of the majority. The ACEC was unable to reach the required 2/3 vote to come up with recommendations on most matters. The report did not include the views of the minority.

The key elements of the sales tax and Internet access tax proposals included in the ACEC's report to Congress are described below.

1. Extend and expand the moratorium—The ITFA moratorium should be extended an additional 5 years. In addition, it should be broadened to also prohibit taxation of digitized goods and their non-digitized counterparts. Thus, for 5 years, no state or local governments would be allowed to collect sales tax on any sale of software, periodicals, books, videos, and any other items that can be digitized.
2. Provide a federal level definition of nexus—The majority proposed that the following factors would not cause a seller to have sufficient nexus for sales tax collection purposes: "(a) a seller's use of an Internet service provider ("ISP") that has physical presence in a state; (b) the placement of a seller's digital data on a server located in that particular state; (c) a seller's use of telecommunications services provided by a telecommunications provider that has physical presence in that state; (d) a seller's ownership of intangible property that is used or is present in that state; (e) the presence of a seller's customers in a state; (f) a seller's affiliation with another taxpayer that has physical presence in that state; (g) the performance of repair or warranty services with respect to property sold by a seller that does not otherwise have physical presence in that state; (h) a contractual relationship between a seller and another party located within that state that permits goods or products purchased through the seller's web site or catalogue to be returned to the other party's physical location within that state; and (i) the advertisement of a seller's business location, telephone number, and web site address."
3. Work towards a uniform sales tax law—State and local governments should work with an existing organization involved in drafting uniform laws for the states to adopt in order to create a uniform sales and use tax act. This uniform act should cover tax base definitions, sourcing rules, audit procedures, and administration. In addition, the majority recommended that a new advisory commission be formed to oversee the work towards a uniform retail sales tax act.
4. No taxes on Internet access charges—A majority of Commissioners (11) proposed that the current moratorium on any transaction taxes on Internet access fees be made permanent including for the taxes grandfathered under the ITFA.

ACEC Minority Report—Five of the eight Commissioners representing government released a report on their own.[41] This report explains the minority's concerns with the majority report, lists several principles that should guide reform and lays out a proposal for state and local governments to address issues of applying sales and use taxes to e-commerce.

1. Concerns with majority report—The minority's concerns with the proposal of the majority is that it would create special "tax privileges" for e-commerce businesses leading to a $20 billion annual shift of taxes to main street businesses and individuals. They also suggest that the majority report is not "tax and technologically neutral" as required by the ITFA because it favors e-commerce businesses. The minority report also states that the majority proposal would undermine state sovereignty by limiting state and local taxing authority and limit the ability to provide local services.
2. Principles of applying sales tax to e-commerce—The principles laid out in the minority report include:
    a. There must be a "level-playing" field where all sellers are treated similarly regardless of their form of distribution.
    b. There must be "radical" simplification of the sales tax.
    c. The Internet should not be a "target" for new taxes.

d. The demand for services of state and local governments will not decline in the future and any changes to the tax system must recognize this.

e. There is no need for the federal government to restrict state and local taxing authority.

f. Changes in the telecommunications industry necessitate updating existing taxes imposed on this industry.

g. Tax policy must not compromise privacy rights on the Internet.

3. Minority sales and use tax proposal—The minority suggests a "streamlined and fair" tax system, which would include the following elements:

a. The moratorium against Internet access taxes and multiple and discriminatory taxes would be extended until simplification efforts are completed.

b. Give the states until the end of 2003 to radically simplify the sales tax. State and local governments should work with the National Conference of Commissioners on Uniform State Laws (NCCUSL) to create a "streamlined sales and use tax system." The features of such a system should include centralized registration, uniform definitions of the tax base, uniform sourcing rules, uniform exemption administration rules, protection of consumer privacy, certification method for software to be used for compliance, uniform returns, and uniform audit procedures. In addition, Congress should adopt legislation to provide that states adopting the streamlined sales tax system will be allowed to collect use tax from remote sellers, although a de minimis rule would exist.

c. Congress should not legislatively define nexus (as suggested by the majority) because doing so focuses too much on physical activity which is not an important factor for e-commerce. Also, under the streamlined sales tax system, it would be simpler to determine tax collection obligations based on a seller's sales volume in the state. In the meantime, states should try to clarify nexus guidelines and have a procedure to enable sellers to determine if they have nexus in the particular state.

d. Telecommunications taxes should be simplified and modified to better address deregulation and other changes in the industry. Consideration should be given to phasing out the 3% federal telecommunications excise tax, if it makes sense given existing federal revenue needs. (A majority of commissioners (11) also proposed to eliminate the 3% federal excise tax on communications services.)

e. Citizens should be kept informed on various proposals and their likely impact to state and local revenues. In addition, revenue neutrality should be a goal.

f. By the end of 2003, the states should develop a uniform and simple system to tax digital products and services that does not violate individual privacy rights or create a compliance burden.

Streamlined Sales Tax Project (SSTP): The SSTP stems from the simplification suggestions made in the minority report of the ACEC and suggestions of the National Governors Association (NGA). A group of representatives from over 35 states met throughout 2000 to create a Model Act and Agreement for a uniform and simplified sales and use tax system. The language was approved by the participating states in December 2000. While additional work is needed to fill in some missing pieces, many states will review the Model Act and Agreement to see if they want to adopt the uniform rules. A few states have already introduced legislation, and at least one state, Wyoming, has already enacted legislation. In addition, multistate vendors will also review the SSTP proposal to understand what it might mean for them should states in which they have customers (whether or not the vendor has nexus (taxable presence) in the state) adopt the SSTP proposal.

The SSTP proposal simplifies the sales tax system for all types of vendors, rather than only for on-line vendors. Features of the SSTP proposal include state level administration of sales and use tax collections, uniformity in the state and local tax bases, a central electronic registration system, uniform sourcing rules, uniform definitions, simplified tax returns, and consumer privacy protections.[42]

<u>Legislative Proposals</u>: Various federal and state legislative proposals to address e-commerce taxation issues have been introduced in the past five years. At the federal level, bills have been introduced to extend the ITFA moratorium, to provide a federal level tax on e-commerce sales, to provide nexus standards for business taxes, and to provide a framework for what a streamlined sales tax system would look like.[43]

APPENDIX C

COMMON MYTHS REGARDING E-COMMERCE TAXATION

Myth: The ITFA exempts e-commerce transactions from taxation.

Reality: The ITFA provides a temporary moratorium on state and local taxes on Internet access, and multiple or discriminatory taxes on e-commerce. The ITFA preserves state and local taxing authority to the extent a particular tax is not covered under the moratorium. Thus, sales and use taxes still apply to sales of taxable items made via e-commerce.

Myth: The ITFA prevents states from imposing use tax collection obligations on remote sellers.

Reality: The *Quill* decision (504 U.S. 298 (1992)) prevents states from imposing use tax collection obligations on remote sellers, not the ITFA.

Myth: Loss of sales and use taxes on e-commerce transactions will not hurt state and local governments. Other revenue sources exist.

Reality: The impact of the loss of sales and use tax revenues varies across jurisdictions. In California, sales and use taxes represent 32% of tax collections at the state level, and for cities, these taxes represent 27% of general revenues. For states without an income tax, the loss is even more significant. For example, Nevada and Texas obtain over 50% of their tax revenues from the sales tax. Even in states with a corporate and personal income tax, most local governments neither have an income tax nor receive income tax revenue from the state government.

Myth: The sales tax problem would be resolved if Congress would pass a law overturning the *Quill* decision.

Reality: The Internet allows a company to have customers in many different locations while having very few physical locations. It also allows new companies to operate in many states without needing any capital for physical (bricks and mortar) expansion. Such new and small companies would likely be put out of business or not seek the market potential presented by the Internet, if faced with obligations to collect use tax from customers in 6,000+ jurisdictions. Thus, it is unlikely that we will see the *Quill* physical presence standard eliminated by Congress under its Commerce Clause authority without significant simplification of the sales and use tax systems in the 46 states and hundreds of local jurisdictions that impose such taxes. Also, while Congress could allow states to collect sales and use tax from remote vendors located in the U.S., it would not be so easy or possible to get vendors in foreign countries to collect state sales tax. Thus, there would still be uncollected sales and use tax unless states can get consumers to voluntarily remit the tax.

Myth: Imposing sales tax on Internet commerce is unfair because buyers are often already paying shipping costs on the goods.

Reality: This argument is a distracter. The purpose of the sales tax is to tax consumption. Just because the buyer has directly paid shipping costs does not mean that consumption has not occurred. Also, buyers always pay shipping costs. The goods at a retail store were shipped there and such costs are factored into the prices paid by customers. Finally, taxes are collected by government and shipping costs do not replace those revenues.

Myth: Online vendors have less infrastructure needs than Main Street Retailers so it does not make sense to make them collect sales and use taxes.

Reality: Many online vendors still use the roads to deliver goods. Also, the consumer resides in the state and the sales tax is a consumption tax to be collected in the state of consumption (market activity).

BIOGRAPHY

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Annette Nellen, CPA, Esq. is a tax professor at San José State University. She primarily teaches Masters of Science in Taxation (MST) courses in tax research, accounting methods, property transactions, taxation of e-commerce, and high technology tax issues. Prior to joining SJSU in 1990 Professor Nellen was with Ernst & Young in Los Angeles and Washington, D.C., and the IRS in Los Angeles. She has written a tax textbook and numerous articles for various tax journals, as well as several tax policy reports submitted to legislative and tax administrative bodies by professional and public interest organizations. She is a frequent speaker to tax professional and governmental groups on tax policy and legislative matters, including various aspects of e-commerce taxation.

Professor Nellen is an active volunteer in professional organizations including the ABA Section of Taxation and the AICPA. She is the Chair of the ABA Tax Section's Sales, Exchanges & Basis Committee and recently completed an assignment chairing the AICPA's Fundamental Tax Reform Task Force. Professor Nellen has served as chair of the Joint Venture Silicon Valley Tax Policy Group since 1995. This government-industry collaborative initiative serves both educational and advocacy roles for tax issues of significance to the Silicon Valley economy, including e-commerce taxation, incentives for getting technology into K-14, state/local fiscal issues, and international tax reform. Professor Nellen is a member of the Board of Trustees of the American Tax Policy Institute (ATPI). She is also a member of the Scientific Committee sponsored by Centro Europeo Studi Tributarie Electronic Commerce (CESTEC) in Rimini, Italy.

Professor Nellen is the faculty advisor to SJSU's Student Chapter of the Institute of Management Accountants (IMA). Professor Nellen is the Vice Chair of the SJSU Academic Senate, the SJSU History webmaster (www.sjsu.edu/SJSUHistory), and the Faculty Coordinator for SJSU's upcoming Freshman Seminar Program. She was named the 2000-2001 Outstanding Professor at SJSU. In 1998, Professor Nellen received the Tax Executives Institute (TEI) Award for Outstanding Contribution to the Silicon Valley Tax Community.

Professor Nellen is a graduate of CSU Northridge, Pepperdine University (MBA), and Loyola Law School.

Professor Nellen maintains web sites on e-commerce taxation, major federal tax reform, high technology links, and the history of San José State University. See *http://www.cob.sjsu.edu/facstaff/nellen_a/.*

[1] The ITFA imposes a 3-year moratorium (from 10/1/98 though 10/21/01) on state and local taxes on Internet access, unless the tax was generally imposed and actually enforced before October 1, 1998. The moratorium also prohibits state and local governments from imposing multiple or discriminatory taxes on e-commerce. Finally, the ITFA established a 19-mombe advisory commission of government and business representatives to study e-commerce tax issues at all levels (international, federal, state and local) and to make recommendations to Congress on proposals with a 2/3 majority vote from the commission members. The commission's report was issued to Congress in April 2000, but was mostly a majority report because of the inability to reach the 2/3 consensus to make most proposals a "recommendation."

[2] A use tax complements a state's sales tax and is imposed at the same rate. A use tax generally applies when a taxpayer buys a taxable item outside of the state for use inside the state. A use tax is the legal obligation of the buyer. For example, when a resident buys a book from a remote (non-present) vendor, the resident is responsible for submitting the use tax to the state taxing agency.

[3] American Institute of Certified Public Accountants (AICPA), Tax Policy Concept Statement 1 – *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, March 2001.

[4] See http://cox.house.gov/press/speeches/2000/0313nlc.htm.

[5] The two cases referred to are *National Bellas Hess, Inc. v. Dept. of Rev.*, 386 U.S. 756 (1967) and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

[6] Congressional Record, January 28, 1999, page S1096. Accessible from http://thomas.loc.gov/cgi-bin/bdquery/z?d106:s.00328:.

[7] Hearing on Internet taxation (107th Congress) at http://www.senate.gov/~commerce/hearings/0314ger.pdf.

[8] Hearing on Internet taxation (107th Congress) at http://www.senate.gov/~commerce/hearings/0314swi.pdf.

[9] Hearing on Internet taxation (107th Congress) at http://www.senate.gov/~commerce/hearings/0314low.pdf.

[10] Office of the Governor, press release of Sept. 25, 2000.

[11] Final report available at http://www.ntanet.org/ecommerce/final.pdf; quote is from page ix.

[12] See http://europa.eu.int/ISPO/ecommerce/legal/documents/com97-157/ecomcom.pdf (p. 19).

[13] Ernst & Young, *The Sky is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by The Internet in 1998*, June 18, 1999.

[14] Austan Goolsbee and Jonathan Zittrain, "Evaluating the Costs and Benefits of Taxing Internet Commerce," May 20, 1999. See http://gsbadg.uchicago.edu/internet.htm.

[15] GAO, *Sales Taxes – Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, GAO/GGD/OCE-00-165, June 2000.

[16] California Senate, *E-Commerce - Taxing Internet Sales and Access*, Pub. #99-1, September 1999.

[17] GAO, *Sales Taxes – Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, GAO/GGD/OCE-00-165, June 2000, Table V.1 and Table V.2.

[18] New @plan Internet Poll™ Reveals Widespread Opposition to Internet Sales Tax, available at http://www.webplan.net/home/investor/investor.htm; September 14, 1999.

[19] "In a World Without Borders: The Impact of Taxes on Internet Commerce," November 1999; see http://gsbwww.uchicago.edu/fac/austan.goolsbee/research/intertax.pdf.

[20] Brian Krebs, Newsbytes, *Government Technology*, February 16, 2001.

[21] Doug Shepard, "State Revenue Officials: Internet Access Tax Repeal Would Cost #90 Million," *State Tax Notes*, 2001 STT 41-30.

[22] CBO Mandates Statement on H.R. 3709, May 8, 2000; ftp://ftp.cbo.gov/20xx/doc2015/hr3709ms.pdf.

[23] While there are over 6,000 jurisdictions that can assess a sales tax, the rules of most local jurisdictions are the same as the state in which they are located. Thus, there are not over 6,000 sets of sales and use tax rules.

[24] *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

[25] Information provided by Vertex, Inc.; www.vertexinc.com/taxcybrary20/salestax_chronicle/taxfacts_main.asp.

[26] For further discussion of sales and use tax complexities, see Joint Venture's Internet Taxation Briefing Paper 2000-4 at http://www.jointventure.org/initiatives/tax/tax_brief4.html.

[27] Washington State Department of Revenue, *Retailers' Cost of Collecting and Remitting Sales Tax*, December 1998; http://www.wa.gov/dor/reports/retail/retailsum.htm. The report also notes that the costs of collection can be offset somewhat by the float that retailers enjoy due to the lag between collection and remittance of the tax, and the ability to deduct these costs on their income tax returns.

[28] Robert J. Cline and Thomas S. Neubig, *Masters of Complexity and Bearers of Great Burden: The Sales Tax System and Compliance Costs for Multistate Vendors*, September 1999; http://www.ey.com/global/vault.nsf/us/masters_of_complexity/$file/complexity.pdf.

[29] COST is a nonprofit organization. Its members consist of over 500 major multistate corporations. "COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities." See http://www.statetax.org/.

[30] The COST Telecommunications Tax Study is available at the COST website at http://www.statetax.org/. It is also reprinted in *State Tax Notes*, January 8, 2001, page 99.

[31] David Streitfeld, "Booking the Future; Does Amazon.com Show That Publishing Clicks on the Internet?" *The Washington Post*, July 10, 1998, page A1. Also see Chip Bayers, "The Inner Bezos," *Wired*, March 1999, page 115, 174. The *Wired* article

notes that Amazon.com also has a warehouse in Delaware that has no state sales tax, and will open a third in Nevada to help serve its large California customer base (without having a presence in California).

[32] Department of Commerce, press release of May 16, 2001, http://www.census.gov/mrts/www/current.html.

[33] James Glave, "Dramatic Internet Growth Continues," Wired News, February 16, 1998, http://www.wired.com/news/topstories/0,1287,10323,00.html

[34] *Quill*, 504 U.S. 298 (1992).

[35] From a speech to the 34th General Assembly of the Inter-American Center of Tax Administrators, released by Treasury on July 10, 2000, LS-759.

[36] Available on the Internet at http://www.ustreas.gov/taxpolicy/internet.html.

[37] Search at http://clinton.nara.gov/.

[38] Links to these reports can be found at http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html.

[39] The NTA Final Report is at http://www.ntanet.org/ecommerce/final_report_cover.htm.

[40] ACEC information can be found at http://www.ecommercecommission.org/.

[41] The report was issued by Commissioners Jones, Leavitt, Lebrun, Kirk, and Locke. The report can be found at Tax Analysts' database, 2000 STT 70-29.

[42] Additional information on the SSTP can be found at http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html.

[43] For a list and description of federal and California bills, see http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html.