

The Internet, Taxation & Simplification

The commercial Internet is now a decade old. Since at least 1997, tax policy has sat squarely at the intersection of digital technologies and public policy. Moratoriums, bit taxes and presidential study commissions have each had a turn in the limelight. Looking ahead, proposals to simplify Internet taxation should not trade consumer protections, tax competition and sovereignty based on consent for improved tax compliance.

Advocates of the Streamlined Sales Tax Project suggest that their simplification proposals would achieve three laudable goals: greater tax equity between various types of commerce (online and offline), larger tax revenues as under-collected taxes become easier to collect and lower administrative costs for the sales and use tax systems.

These propositions are empirical; therefore, they are debated with gusto. Two more categories of problems with SSTP exist and merit attention:

Constitutional Hurdles – Three sections of the United States Constitution must be addressed before a multi-state arrangement for reciprocal tax collection and rate-setting is enacted. Article 1, Section 10 includes the Import-Export Clause and the Compact Clause. The Import-Export Clause explicitly states that all revenues that result from taxes on interstate goods “shall be for the Use of the Treasury of the United States.”¹ Furthermore, the Interstate Compact Clause requires the express consent of Congress to “enter into any Agreement or Compact with another State.” Finally, the Commerce Clause protects interstate commerce – buyers and sellers in the marketplace – and not the prerogatives of tax collectors who have difficulty adjusting their practices to the realities of interstate commerce. These salutary provisions are real and formidable if not often recognized.

Practical Hurdles – SSTP’s dangers to consumer privacy are real. By far, the greatest threats to consumer control over private information come from public sector data collection and management, particularly by tax authorities.² Second, many states do not have the legal authority to mandate single tax rates within a locality.³ Finally, as commercial activity migrates to transaction intensive media like the Internet, it may be time to adopt new tax systems rather than attempt incremental improvements to existing systems. Sales and use taxes are simply not suited to digital commerce.

In general, the sales and use tax “simplification” proposals are defective because they encourage states to delegate local revenue decisions to a cartel-like institution with the power to affect tax law in each member state. Cartels fix prices and limit competition. Like a cartel, the SSTP uniform tax rates would eliminate tax competition for additional commerce among jurisdictions. Unfortunately, the marketplace for policy solutions – particularly solutions to the evolving administrative challenges presented by the Internet and other digital media – would have a reduction in innovative behavior. In all, the costs of the SSTP simplification proposal do not warrant its adoption.

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¹ For a detailed examination of the terms import, export, duties and imposts see the opinion of Justice Clarence Thomas in *Camps Newfound/Owatonna, Inc. v. Town of Harrison et. al.*, (520 U.S. 564) 1997. See also Kent Lassman and Anna Duff, “*The Internet, Taxation, and the Constitution*,” The Claremont Institute, September 2001.

² See for example, Alan Raul, “*Privacy and the Digital State*,” The Progress & Freedom Foundation, 2001.

³ See Governor Bill Owens, “*Nine Problems with Taxing the Internet*,” Center for the New American Century, Forthcoming June 2003.