INTERNET TRANSACTION TAXES: THE NEED FOR JURISДСCITIONAL INTEGRATION

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I. INTRODUCTION

A. Federal Government—Do as we say, not as we do

Much has been written about the relationship between federal and state governments with respect to the state’s authority to tax transactions and their ability to require tax collection.\(^1\) Perhaps some of the confusion lies in the logical argument that if a jurisdiction has power to tax, then it also has power to require individuals or entities to collect such tax. For example, the federal government taxes individuals on the income earned from capital gains, dividends and interest.\(^2\) Yet the federal government requires financial institutions holding such investment to report income information to the individual and to the Internal Revenue Service ("IRS").\(^3\) Thus, the federal government has added a significant burden and cost to the financial institution with no offsetting benefit. This is done all in the name of increasing “voluntary” compliance but is in reality a coercive measure to ensure reporting of such income by the individual because the individual is now “on notice” that the IRS has the income information.

Yet, in the area of state and local transaction taxes,\(^4\) the Supreme Court, through case law, and Congress, through inaction, have imposed limitations on the states’ ability to enforce compliance with their laws. This limitation jeopardizes state revenues and confuses the tax policy debate regarding Internet taxation—specifically, transaction taxes on Internet purchases.\(^5\)

B. The Internet—What is it?

In 1969, an experimental project bore what

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\(^1\) Transaction taxes are more commonly referred to as sales and use taxes. One of the obstacles to resolving the issue of collection of such tax lies in the bifurcation of the one tax, a tax on transactions, into what appears to be two distinct and different taxes: a sales tax and a use tax. In reality these “two taxes” are one and the same—a tax on a transaction (i.e., on the sale of an item). Unfortunately, this bifurcation contributes to the confusion and to the political rhetoric characterizing expansion of collection requirements as imposing a “new” tax.


\(^3\) See id. at § 6045 (Supp. IV 1999).

\(^4\) Hereinafter “transaction taxes” refers to both state and local sales and use taxes.

\(^5\) See Matthias Manz, letter to the editor, Direct to You, Tax Free, WASHINGTON POST, Mar. 27, 2000, at A26. The author noted:

I have made several purchases through Priceline.com, which I then picked up at my local Giant. I received a substantial discount on those items, which also were free of sales tax. When I pick up the items, a Giant employee rings up [the] sale—including tax—at the register, but I’ve already paid Priceline.com, where the price does not include any tax. Priceline.com seems to offer retailers a means of selling goods tax-free. The businesses simply set up a [website], direct their customers to make purchases there and then have them come into the store to pick up the items. Retail stores could set up computer terminals on their premises or even substitute a [website] for a cash register. The Post article said Giant intends to have its own [website] operating within the year. If electronic commerce is not subjected to sales tax, then that tax’s days as a significant source of government revenues are numbered. Maybe this is the covert goal of conservative politicians such as Virginia’s Gov. James Gilmore.

Id.
would later become known as the Internet. The Internet, which initially only connected government with academia,\(^6\) was significantly expanded in 1986 with the development of a high-speed network.\(^7\) This new network expanded and accelerated access.\(^8\) It was not until 1993, with the development of the user-friendly interface commonly referred to as the Web, did the Internet’s commercial applications begin to be realized.\(^9\)

The Internet is the interconnection of hundreds of thousands of computers functioning as postal substations routing data packets by the best route available.\(^10\) Several packets may make up a single message and may travel along different routes, recombining back into the single message at the destination.\(^11\) The “roads” for the data include telephone networks, cable TV systems, satellite links and fiber optic cables.\(^12\) Because of these characteristics, the Internet has been called a “global network of networks.”\(^13\)

The Internet is not, however, a telecommunications service.\(^14\) The Telecommunications Act of 1996\(^15\) (the “1996 Act”) defined “telecommunications service” as the “offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.”\(^16\) In contrast, the 1996 Act defined “information service” as “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications.”\(^17\) For Internet providers, parity with the telecommunications industry would bring with it the same regulatory standards and tax requirements.\(^18\) This would move Internet providers from an environment of little regulation and tax requirements to one of significant regulation and tax requirements.

C. The Future of the Internet

Although many consider the Internet industry young,\(^19\) current statistics show the significant impact of the Internet.

1. Access to the Internet

The Department of Commerce reported that access to the Internet would reach 304 million people worldwide in 2000.\(^20\) Not all of the Internet’s use, however, involves the consumer purchase of a tangible good. In fact, Internet use more likely involves e-mail; checking information such as sports, news, weather and schedules; and making reservations.\(^21\) Nonetheless, the Internet


\(^7\) See Commerce Paper, supra note 6, at 2; ISA White Paper, supra note 6, at 211 (“In 1986 the National Science Foundation (NSF) developed its high-speed network to allow researchers access to NSF’s new supercomputer sites and provide a faster medium for data transmission between the sites.”).

\(^8\) See ISA White Paper, supra note 6, at 211.

\(^9\) See id. at 211.


\(^11\) See id.; see also The Accidental Superhighway: A Survey of the Internet, The Economist, July 1, 1995, at 6 [hereinafter The Economist].

\(^12\) See The Economist, supra note 11, at 3.


\(^14\) See generally 47 U.S.C. § 153(46) (Supp. IV 1999); see also ISA White Paper, supra note 6, at 215 (“The fact that Congress did not intend Internet and online services to be classified as telecommunications services is evidenced by the plain wording of the 1996 Act, which makes it clear that the services offered by Internet and online service providers are not telecommunications services.”).


\(^17\) 47 U.S.C. § 153(20).

\(^18\) See ISA White Paper, supra note 6, at 215 (“A ny decision that Internet and online services are telecommunications services would undermine the long-standing distinction made by the FCC between ‘basic services’ (which were to be subject to regulation), and ‘enhanced services’ (which were not to be subject to regulation.”).

\(^19\) See ISA White Paper, supra note 6, at 213 (“Internet and online services are experiencing rapid growth, but it is important to recognize that the Industry is still relatively young.”).


is providing a new medium for retailers to market their wares by supplementing paper catalogs for mail-order companies,\textsuperscript{22} and extending the reach of once only brick-and-mortar retailers.\textsuperscript{23} The Internet's expansion is limitless. It offers twenty-four hour, seven-day-a-week access to every home and business for virtually any kind of service or product.\textsuperscript{24}

2. Types of Transactions

Internet transactions are as diverse as brick-and-mortar retail transactions. Purchases of goods over the Internet include clothing, furniture, toys, books, videos, computer products, music, flowers and food.\textsuperscript{25} The Internet also provides a new medium for services (online services and consumer services such as financial, legal and tax return preparation services), and the business community is responding by forming strategic alliances to take advantage of such limitless opportunities.\textsuperscript{26} Technology-interested firms note, or perhaps warn, that "the growth of Internet and online services will be increasingly important to every state's economic development . . . [T]echnological opportunities will naturally migrate to states that are tax-friendly."\textsuperscript{27}

3. Number of Transactions

The number of transactions conducted over the Internet continues to leap at amazing rates of growth. Transactions of tangible personal property totaled $500 million in 1995.\textsuperscript{28} In a mere 3 years, sales increased to $5.9 billion.\textsuperscript{29} In 1997, a study estimated that sales would reach $6.6 billion by 2000.\textsuperscript{30} Of note, however, is that by 1999, sales doubled from their 1998 levels to $11.04 billion.\textsuperscript{31} In the second quarter of 2000 alone, the estimate of U.S. retail e-commerce sales was $5.5 billion.\textsuperscript{32} As a percentage of total retail sales, the $5.9 billion in 1998 accounted for 0.2% of total retail sales.\textsuperscript{33} By 2004, these Internet transactions are expected to account for 2.5% of total retail sales.\textsuperscript{34}

4. Significant Industry

Some have argued that use of the Internet is insignificant.\textsuperscript{35} Are these commentators trying to convince policy-makers that the Internet is simply not worth their time and energy? Perhaps a general laissez-faire approach to the Internet is desired, and perhaps that approach can and should be argued on its merits, rather than trying to de-
tract from the real issue with claims of such a "young" (i.e., insignificant) industry.

How much is enough? How big is big enough? When is the Internet "grown up?" Internet transactions are sufficiently significant and widespread for those opposing government policies regarding the Internet to finally admit that this new technology has "grown up." As such, it is time for jurisdictional integration through uniform, equitable and neutral tax policies for all transactions, regardless of the medium.

II. TRANSACTION TAXES AND "ADVANCES IN COMPUTER TECHNOLOGY"37

As stated supra, the limitation on the states' ability to "enforce" compliance with their tax laws—specifically transaction taxes on Internet purchases—jeopardizes state revenues and confuses the tax policy debate regarding taxation of the Internet.38

A. Purpose of Transaction Taxes

"Under the Constitution, a state or local government may impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction."39 Transaction taxes serve as an important source of state and local government revenue.40 Transaction taxes based on the sale of tangible property and certain services are bifurcated into a "sales tax" and a "use tax." A transaction tax is essentially a tax imposed on consumers, based on their location and the location of consumption.42 The distinction is that sales tax is imposed on sales by an in-state retailer because it is assumed the purchaser will consume the item in the state of purchase. A use tax, however, is imposed on sales by an out-of-state retailer because the item is presumably consumed within the purchaser's state of residence. The issue is, therefore, who should collect use taxes, not who should pay.

37 See generally Quill v. North Dakota, 504 U.S. 298, 303 (1992). The Court stated the facts of the case, noting that: Quill has taken the position that North Dakota does not have the power to compel it to collect a use tax from its North Dakota customers. Consequently, the State, through its Tax Commissioner, filed this action to require Quill to pay taxes (as well as interest and penalties) on all such sales made after July 1, 1987. The trial court ruled in Quill's favor, finding the case indistinguishable from Bellas Hess; specifically, it found that because the State had not shown that it had spent tax revenues for the benefit of the mail-order business, there was no 'nexus to allow the state to define retailer in the manner it chose.' The North Dakota Supreme Court reversed, concluding that 'wholesale changes' in both the economy and the law made it inappropriate to follow Bellas Hess today. The principal economic change noted by the court was the remarkable growth of the mail-order business 'from a relatively inconsequential market niche' in 1967 to a 'goliath' with annual sales that reached 'the staggering figure of $183.3 billion in 1989.' Moreover, the court observed, advances in computer technology greatly eased the burden of compliance with a 'welter of complicated obligations' imposed by state and local taxing authorities.

40 See generally Jerome R. Hellerstein et al., STATE AND LOCAL TAXATION: CASES AND MATERIALS 2-3 (6th ed. 1997). Receipts for state and local governments have grown tenfold in 80 years from $400 million in 1915 to $3.9 billion in 1995. Further, with $132 billion (34% of revenue) of transaction taxes collected in 1995, it serves as the primary source of state revenue for 45 states and the District of Columbia. See also Alison Bennett, Debate Foreshadows E-Commerce Battle As Gilmore Defends Commission Report, BNA DAILY TAX REP., Apr. 7, 2000, at G6-G7 (citing Rep. Gene Green's (D-TX) statement that ACEC's "proposal would put states such as Texas, which rely solely on sales tax, in a very difficult position").
41 See BLACK'S LAW DICTIONARY 1339 (6th ed. 1990) (defining a "sales tax" as "a state or local-level tax on the retail sale of specified property or services[.]") which is generally paid by the purchaser and collected by the seller "as an agent of the government"); id. at 1543 (defining a "use tax" as a "sales tax that is collectible by the seller where the purchaser is domiciled in a different state" and a tax imposed on the "use, consumption, or storage of tangible property, usually at the same rate as the sales tax, and levied for the purpose of preventing tax avoidance by the purchase of articles in a state or taxing jurisdiction[.] which does not levy sales taxes or has a lower rate"); see also Henneford v. Silas Mason Co., 300 U.S. 577, 581 (1937) (upholding the constitutionality of the use tax).
42 See Robert J. Cline & Thomas S. Neubig, Masters of Complexity and Bearers of Great Burden: The Sales Tax System and Compliance Costs For Multistate Retailers, Ernst & Young, LLP, 24, available at http://ecommercecommission.org (Sept. 8, 1999) [hereinafter Cline & Neubig]. This document was prepared for the eCommerce Coalition, which is a "a broad-based, national coalition dedicated to providing sound policy information on electronic commerce taxation." Id. at 1.
B. Constitutional Limitations

The two seminal cases involving the constitutional limitations on a state's authority to impose transaction tax collection requirements on out-of-state retailers are *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* 46 and *Quill v. North Dakota.* 44 *National Bellas Hess* limited the state's authority to require transaction tax collection based on the Due Process Clause 45 and the Commerce Clause. 46 The case involved a mail-order catalog company incorporated in Delaware, which the court held was not required to collect transaction taxes from Illinois consumers. 47 The Supreme Court held that *National Bellas Hess* lacked a physical presence (nexus) 48 in Illinois. 49 Thus, the state lacked the proper jurisdiction to impose collection authority for transaction taxes.

1. Due Process Clause

Twenty-five years later the Supreme Court replaced its earlier due process limitation with a Commerce Clause limitation. 50 The Supreme Court held in *Quill* that the Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.” 51 In rejecting its previous due process holdings, the Court examined the evolution of its jurisprudence. 52 In applying its holding in *Burger King Corp. v. Rudzewicz,* 53 the *Quill* Court held that:

“Comparable reasoning justifies the imposition of the collection duty on a mail-order house that is engaged in continuous and widespread solicitation of business within a State. Such a corporation clearly has 'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.' In 'modern commercial life' it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State.” 54

2. Commerce Clause

The Commerce Clause grants Congress the power to “regulate Commerce with foreign Nations, and among the several States.” 55 One aspect of the Commerce Clause also is referred to as the “negative” or “dormant” Commerce Clause. The Court held in *South Carolina State Highway Department v. Barnwell Brothers, Inc.* 56 that “by its own force” the Commerce Clause prohibits certain state actions that interfere with interstate commerce. 57 The *Quill* Court recognized the evolution of its Commerce Clause jurisprudence, 58 with limitations.

The *Quill* majority’s characterization of its own decision in *Complete Auto Transit, Inc. v. Brady* 59 challenges logic. 60 *Complete Auto* established a four-prong test used to sustain a tax under the Commerce Clause. 61 The Court in *Quill*, while re...
jecting Complete Auto as a basis for overturning its decision in National Bellas Hess, admitted that the evolution of Commerce Clause jurisprudence would not dictate such a result.62 The Court justified its diversion from overturning National Bellas Hess, stating that “the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.”63 It is difficult to understand how the Court saw structural concerns as different from those mechanisms ensuring fairness.

The Court also urged that its holding perpetuated the bright-line rule for transaction taxes, stating that “[s]uch a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes.”64 Ironically, the Supreme Court was merely passing the buck to Congress. The Court rationalized its lack of action because “Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”65 As such, the majority refused to find “substantial nexus.”

C. Failings of the Transaction Tax

This failure to provide a fair, equitable and neutral approach to transaction tax collection has left the states trying to find the proverbial “edge” of the envelope,66 has left retailers burdened by the uncertainty of state enforcement and has left consumers with the impression that sales over the Internet are not subject to transaction taxes.

1. Lack of Uniformity—Burden of Compliance

State sovereignty allows state and local governments to institute their own tax rate, tax base and compliance requirements (e.g., audits, tax return filing requirements, payment frequency, forms, registration). The District of Columbia and 45 states impose a transaction tax.67 Localities within 33 states68 impose transaction taxes and also may institute their own tax rate, tax base and compliance requirements. Also, with respect to the local jurisdictions, their boundaries do not necessarily correspond to the postal ZIP codes.69 The result is that a business operating nationally is confronted with 7,600 individual taxing jurisdictions,70 with over 1,300 in Texas alone.71 The magnitude of compliance could be even worse if every local government imposed a sales and use tax.72

The burden of compliance, however, with transaction taxes is too often discussed only in terms of the burden faced by the retailer. But there is a burden on the individual—the voluntarily compliant individual—of record keeping and tax base calculations.73 Ironically, the Supreme Court’s limitation on the duty of retailers to collect transaction taxes because of the interstate burden actually imposes a greater burden on the compliant consumer.74

279 (1977). The test is whether a “tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.” Id.

62 See Quill, 504 U.S. at 311 (“While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, Bellas Hess is not inconsistent with Complete Auto and our recent cases.”).

63 Id. at 312.

64 Id. at 315.

65 Id. at 318.


67 See Cline & Neubig, supra note 42, at 14 (noting that five states do not have a transaction tax: Alaska, Delaware, Montana, New Hampshire and Oregon).

68 See AEC REPORT TO CONGRESS, supra note 23, at 17.


71 See Cline & Neubig, supra note 42, at 1.

72 See id.

73 See generally John Simons, States Chase Web Shoppers Ignore Sales Taxes, WALL ST. J., Jan. 26, 1999, at B1 [hereinafter Simons] (“Believe it or not, the burden is on you to calculate and pay the state and local taxes on what you buy. But if you’re like the overwhelming majority of Internet shoppers, you’re likely to leave that tax unpaid.”).

74 See generally John Schwartz, Internet Tax Panel to Hold Final Meeting: States Try to Untangle Issue of Web-Based Sales Tariffs, WASHINGTON POST, Mar. 20, 2000, at A4 [hereinafter
2. Cost of Compliance

The resulting compliance and/or administration costs lie significantly with businesses, not governments. The compliance costs borne by small and medium size retailers would prove to be an unacceptable cost for a tax agency. For example, if a retailer establishes taxable nexus in just 15 states, the retailer's compliance costs rise in inverse proportion to its size: from 7.2% to 90% for small retailers, from 3.7% to 33% for medium retailers and from 1% to 8.3% for large retailers. If a retailer expands operations nationwide, compliance costs jump higher. For a medium retailer, costs jump to 48%. Further compliance with local transaction taxes alone accounts for over 50% of the compliance burden for small and medium size retailers. As such, if a retailer sells goods over the Internet, it is likely that such retailer operates nationwide and is potentially subject to significant compliance costs.

State sovereignty, however, in the era of the local merchant to the local customer, “is no longer possible, or at least not a realistic alternative, as it implies enormous complexity for remote vendors and thus the legal inability to tax remote sales, including those in electronic commerce.” States must challenge the benefits received (maintaining revenue sources) for the cost (giving up some state sovereignty).

Id. 75 See generally eCOMMERCE COALITION, SIMPLIFICATION OF THE STATE AND LOCAL SALES AND USE TAX SYSTEM, 2 at http://ecommercecommission.org (Nov. 15, 1999) [hereinafter SIMPLIFICATION]; see also Cline & Neubig, supra note 42, at 16 (citing WASHINGTON STATE DEP'T OF REVENUE, RETAILERS' COST OF COLLECTING SALES TAX STUDY, available at http:// dor.wa.gov/reports/retail/retailstudy.doc (Dec. 1998) [hereinafter WASHINGTON STATE COMPLIANCE STUDY]). The compliance study noted that for in-state retailers (i.e., operating in one state), the compliance costs as a percentage of sales tax collected for small retailers are 7.2%, 3.7% for medium retailers, and 1% for large retailers. In contrast, the cost of administering the sales tax system is no more than 1% of taxes collected for a state’s department of revenue. WASHINGTON STATE COMPLIANCE STUDY, this note.

3. Lack of Enforcement

The consumer pays transaction taxes. It is the collection of these taxes that is at issue. “The low level of use tax compliance suggests that consumers are not aware of their use tax liabilities, do not voluntarily comply with the law, or that the enforcement efforts of taxing jurisdictions are low, ineffective or nonexistent.” Collection is an issue, in part, because of the near impossible task facing states to collect transaction taxes on sales made to in-state residents from out-of-state retailers. The result is an extremely low compliance rate for such tax; estimated annual lost revenue to state and local governments is over $3.5 billion.

D. Requirements for Expanded Nexus

As the number of Internet transactions increases, the need for certainty in compliance is essential to states in terms of revenue and to individuals in terms of meeting their legal obligation to pay their tax liabilities. Expanded nexus provides this certainty and ensures that all taxpayers comply with their transaction tax liability because collection is imposed at the retail level for all transactions.

Plans for changes to the transaction tax systems of states and localities have more similarities than differences. Unfortunately, in the typical negotiat-

75 Cline & Neubig, supra note 42, at 16 ("An administrative cost ratio of 4 to 7% of tax collections would not be acceptable from a state budget perspective.” (citing JOHN F. DUE & JOHN L. MIKESELL, SALES TAXATION: STATE AND LOCAL STRUCTURE AND ADMINISTRATION 325 (1983))).
77 See Cline & Neubig, supra note 42, at 20.
78 See id. at 21.
79 Id. at 23 (citing WASHINGTON STATE COMPLIANCE STUDY, supra note 75).
80 McLure, supra note 69, at 7.
81 Cline & Neubig, supra note 42, at 5.
82 See Internet Tax and Trade Issues: Hearing on S. 442 and H.R. 4105 Before the Senate Comm. on Finance, 105th Cong. 51, 55 n.3 (1998) (statement of Harley T. Duncan, Executive Dir. Fed’n of Tax Adm’rs) [hereinafter Duncan Statement]; see also Cline & Neubig, supra note 42, at 5-6 ("[S]tate and local governments are questioning the system’s effectiveness in collecting sales and use taxes on their citizens’ purchases from remote sellers . . . but noncompliance is a significant problem for consumer purchases . . . Even if consumers know that a use tax liability exists, payment of the tax may not be straightforward or convenient.").
ing strategy, the states do not want to give up on uniformity if the retailers do not give up on expanded collection requirements.84 This state of purgatory can only be resolved with federal intervention requiring the following three changes to transaction taxes.

1. Require Inquiry into State of Residence

The only way to achieve a neutral, fair and simple transaction tax system is to require the same collection responsibility by each retailer.85 Essentially, a state would impose collection requirements without regard to physical presence in a state. Accepting that the Internet lacks geographical boundaries and that the world is becoming a global marketplace, it is reasonable to examine the relationship among countries as a basis for taxation at the subfederal (state) level. "The United States, as do most countries, asserts jurisdiction to tax based on principles of both source and residence. If double taxation is to be avoided, however, one principle must yield to the other."86 This is accomplished through tax treaties with other countries. "[C]ountries tend to restrict their source-based taxing rights with respect to foreign taxpayers in order to exercise more fully their residence-based taxing rights."87 The growth in Internet technologies, from a country-to-country perspective, "will likely require that principles of residence-based taxation assume even greater importance. In the world of cyberspace, it is often difficult, if not impossible, to apply traditional source concepts to link an item of income with a specific geographical location . . . [whereas] almost all taxpayers are residents somewhere."88

On a state level, the Supreme Court's decision in Goldberg v. Sweet89 establishes a foundation for the application of expanded nexus and imposition of tax based on residency. In Goldberg, the Court held that a consumer's service address should be used for situsing telecommunications transactions for purposes of imposing tax.90 Industry representatives have urged such an approach. Using Goldberg for transaction taxes, "a practical agreement between the [i]ndustry and the states to rely on the subscriber's billing address as the equivalent of the service address in determining the situs of a sale could solve most problems" with the transaction taxes.91

2. Require One Rate Per State

With 7,600 jurisdictions imposing a transaction tax,92 one solution to this complexity is to allow each state to retain sovereignty while restricting the localities from setting their own tax rates.93 The states could then establish an allocation mechanism to distribute the taxes to the localities.94 The states also should have uniform registration, form filing requirements, audit standards and record-keeping requirements.

3. Require A Uniform Menu for the Tax Base

As with the tax rates, the complexity resulting from the current ability of the states and localities to set their own tax base is excessive. One reason for this variation is the absence of a national sales tax that could provide a standard tax base; in the case of the income tax, most states piggyback on the federal definition of taxable income. More importantly, the variation comes from the fundamental fact that the tax is a transaction tax that can be adjusted to include an almost infinite combination of goods and services in the tax base.95 The solution to such complexity is to require

84 See NTA, supra note 70, at 5, 10 ("[I]t immediately became clear that any effort to draft a statute was premature in light of the numerous areas of disagreement and uncertainty . . . Nothing is agreed to until everything is agreed to.").
85 See McLure, supra note 69, at 1 ("Sound public policy demands that remote vendors, including those engaged in electronic commerce, collect use tax on their sales.").
86 TREASURY PAPER, supra note 6, at 22.
87 Id.
88 Id. at 25.
90 See generally Goldberg, 488 U.S. at 254.
91 ISA WHITE PAPER, supra note 6, at 219.
92 NTA, supra note 70, at i.
93 See generally id. at 23.
94 For example, in Virginia, a retailer collects a transaction tax from the consumer at the rate of tax of 4.5%; 3.5% remains with the state government and 1% is distributed to the appropriate local government. See VIRGINIA DEP'T OF TAXATION, VIRGINIA BUSINESSES SALES AND USE TAX, at http://www.tax.state.va.us/btsutax.htm (last visited Oct. 3, 2000).
95 See NTA, supra note 70, at 12 ("In Rhode Island and Minnesota, shoes with cleats are taxed, but sports shoes without cleats are exempt. Above the knee boots are taxed in Minnesota, and Texas does not exempt clothing but exempts protective boots with a life-span of less than six months."). Another source of complexity is the increasing interest in "holidays." New York, Florida and Texas have provided "holidays" during which certain items in the tax base are exempt
the states to use a uniform tax base "menu" based on classifications of products to include or exclude from a state's tax base using the United Nations Central Product Classification system as a model.96 This maintains state sovereignty while ensuring greater uniformity.

III. IMPACT OF THE INTERNET ON THE TRANSACTION TAX DEBATE

A. Growth in the Internet—Growth in the Problem

The failings of the transaction tax enforcement on consumer purchases from out-of-state retailers result in more than just a loss of revenue—it results in a competitive advantage for out-of-state retailers and discrimination against in-state retailers.97 The problem is heightened with the growth of online businesses and the migration to Internet purchases, away from “Main Street” purchases. Further, the Supreme Court’s failure in Quill to overturn National Bellas Hess with respect to both the Due Process Clause and the Commerce Clause insulates retailers who lack taxable nexus, such as Internet retailers (“e-tailers”). Internet retailers present the same challenges in the transaction tax debate as mail-order catalog retailers, but with increased volume and reach.98

B. Lack of Geographical Boundaries—The Unknown Consumer

A unique feature, however, of Internet sales is the simultaneous blurring of “both the geographical boundaries between states and the definitional boundaries between goods and services.”99 By design, the Internet (and thus the Internet retailer) does not know the location of the consumer.100 “The Internet has no physical location . . . [I]n principle and generally in practice, it makes no difference whether the information or electronic money sought to be transmitted are within one jurisdiction or between several, as the Internet pays little or no regard to national boundaries.”101

Yet therein lies the problem. Retailers, who are required to collect transaction taxes based on the source or destination addresses, are limited by the “unknown” location of the Internet. State and local governments predict further erosion of their revenue base as the consumption of tangible goods via the Internet increases. This erosion is based on unknown locations and Supreme Court limitations.102

C. Forest for the Twigs

As previously discussed, the Internet presents unique problems not faced by mail-order catalog retailers. Such problems include the ability to use “unaccounted” electronic money,103 to bundle taxable and nontaxable goods and services,104 and to deliver digital products.105 The details of these problems are beyond the scope of this article. However, the more significant concern is that these problems should not overshadow the issue. Fair, neutral and simple tax policies should ad-

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96 See NTA, supra note 70, at iii-iv.
97 See McClure, supra note 69, at 1.
98 See generally Robert J. Cline & Thomas S., Neubig, The Sky is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by the Internet in 1998, 8 n.9, at http://www.ecommercecommission.org/document/goolsbee14.pdf (Jun. 18, 1999) [hereinafter Sky Falling] (“In a recent study of online retail transactions, the author found that online computer sales and mail-order sales are very similar in terms of responses of purchasers to tax rate differences. This suggests there may be a high degree of substitution between mail-order and online computer sales.” (citing Austan Goolsbee, In a World Without Borders: The Impact of Taxes on Internet Commerce, at http://www.ecommercecommission.org/document/goolsbee14.pdf (Nov. 1998))).
99 Sky Falling, supra note 98, at 1.
100 See ISA WHITE PAPER, supra note 6, at 210; see also TREASURY PAPER, supra note 6, at 20 (“The pieces of an Internet address . . . tell you who is responsible for maintaining that name. It may not tell you anything about the computer corresponding to the actual Internet address, or even where that machine is located . . . Untraceable use of an Internet site, with the permission of the site’s controllers, is quite easy to arrange.”).
101 TREASURY PAPER, supra note 6, at 19.
102 See generally ISA WHITE PAPER, supra note 6, at 210, 220.
103 See TREASURY PAPER, supra note 6, at 16 (“In an unaccounted system, the e-money is issued and passes through the economy without a transaction trail . . . [and moves] through the economy anonymously.”).
105 See id.
dress the collection and imposition of transaction taxes.

Any taxation of Internet sales should . . . neither distort nor hinder commerce. No tax system should discriminate among types of commerce, nor should it create incentives that will change the nature or location of transactions. The system should be simple and transparent. It should be capable of capturing the overwhelming majority of appropriate revenues, be easy to implement and minimize burdensome record keeping and costs for all parties.106

Once that larger issue is resolved, these nuances should then be pursued.

D. Is Technology the Answer to Taxation of the Internet?

In Quill, the Supreme Court’s holding was premised on an undue burden on interstate commerce resulting from collection responsibility imposed on the out-of-state retailer. Today, technology not only provides the Internet, but it also reduces the burden necessary to overcome further Commerce Clause objections.107

Some nationally operated retailers already voluntarily collect transaction taxes based on the destination of the tangible personal goods.108 “For multistate sellers that have nexus to collect taxes in a number of states, it becomes economically feasible to use commercially available software packages or tax service providers to determine jurisdiction-by-jurisdiction tax rates and bases for each transaction and to prepare and submit state and local tax returns.”109 Regardless of the type of uniformity adopted, or lack of adoption, the technology is available to ease the collection burden.110

Other retailers express concern with the cost of the technology required to calculate transaction taxes for all state and local governments. A portion of the costs of technology could be offset as under current law. Some states currently provide a discount to retailers to offset the cost of collection and others are willing to adopt such a system.111 In the end, “the problem is one of magnitude, and the resolution resides within technology.”112

IV. THE LEGISLATURES AND THE TRAGEDY OF THE COMMONS

A. The Internet Tax Freedom Act

The Advisory Commission on Electronic Commerce (the “Commission”) was formed as part of the Internet Tax Freedom Act of 1998.113 When the Commission was formed, some business and anti-tax organizations were concerned that it promise the buyer’s privacy or impose new kinds of taxes.); e.g., R. Scot Grierson, Constitutional Limitations on State Taxation: Sales and Use Tax Nexus on the Information Highway, 10 STATE TAX NOTES 589, 597 (1996) (“The technology to track sales under such a sourcing scheme [using the Universal Product Code requirement] may already exist. AVP Systems has already announced development of software capable of permitting merchants to track sales tax for users of online services in North America.”).

111 See Schwartz, supra note 74, at A4 (quoting John Truscott of Gov. John Engler’s (R-MI) office, “We believe that there is technology available that would allow very easy tax collection to be done by the companies and we’re willing to pay them for it.”).


113 Pub. L. No. 105–277, Div. C, Title XI Stat. 2681–719 (codified as amended at 47 U.S.C. § 151 (Supp. IV 1999)). The law also established a three-year moratorium on new or discriminatory taxes. During such time the Commission was to engage in the “study of Federal, State, and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities.” 47 U.S.C. § 151(g)(1).
would favor the side of the state and local governments, and expand the authority of the states to require out-of-state retailers to collect transaction taxes.\textsuperscript{114} "States and localities believe[d] the Internet Tax Freedom Act should be used as a vehicle to put in motion an examination of a simpler, more uniform, more evenly applied sales tax system that will be required in this country in the 21\textsuperscript{st} Century."\textsuperscript{115} As a result, Congress imposed the requirement of a two-thirds vote in order to report recommendations to Congress.\textsuperscript{116} Ironically, the two-thirds vote served to protect the states from the anti-tax organizations by restricting the ability of the anti-tax organizations to make biased, nonmajority supported recommendations to Congress.\textsuperscript{117}

During debate on the Internet Tax Freedom Act, Senator Wyden made clear that "the bill would not preempt state and local taxes that are currently on the books."\textsuperscript{118} In his view, the rationale for the moratorium was to "call a time-out on the proliferation of taxes that single out electronic commerce."\textsuperscript{119} The administration viewed the Commission as an opportunity to "explore the longer-term tax issues raised by electronic commerce, in order to develop a policy framework that [was] fair to states and localities while allowing the Internet to earn its fair place in the ever-changing business world."\textsuperscript{120} Nonetheless, once formed, Governor James S. Gilmore III (R-VA) became chairman of the Commission and became "[t]he strongest voice against taxing Internet purchases."\textsuperscript{121}

The Commission’s Report to Congress reflected the contentious nature of the Commission. Instead of meeting its purpose, the Commission failed to gain two-thirds support from its members for all but three issues—none of which addressed the transaction tax dilemma.\textsuperscript{122} Furthermore, the Commission’s recommendations have not received the necessary support from Congress\textsuperscript{123} or the states.\textsuperscript{124} The prospects for congressional ac-

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\textsuperscript{114} See Interview with Stan Fendley, U.S. Senate Comm. on Finance, Minority Tax Counsel (Mar. 22, 2000) [hereinafter Fendley Interview] (on file with author); see also Duncan Statement, supra note 82, at 51–52 ("Any legislation passed by the Congress should be prospective only and should not preempt taxes that are currently imposed by state and local governments on various aspects of electronic commerce.").

\textsuperscript{115} Duncan Statement, supra note 82, at 53.

\textsuperscript{116} The Nat’l Governors’ Ass’n supported an expanded role for the Commission, which included determining how interstate sales tax collection should apply to all cross-border sellers, including mail order firms. See Internet Tax and Trade Issues: Hearing on S. 442 and H.R. 4105 Before the Senate Comm. on Finance, 105th Cong. 77 (1997) (statement of Raymond C. Scheppach, Nat’l Governors’ Ass’n); cf. Internet Tax and Trade Issues: Hearing on S. 442 and H.R. 4105 Before the Senate Comm. on Finance, 105th Cong. 68 (1998) (statement of Mark A. Macali, Direct Marketing Ass’n) (noting that the Direct Marketing Ass’n opposed a broad mandate of formulating a policy regarding interstate sales tax collection).

\textsuperscript{117} See Fendley Interview, supra note 114.


\textsuperscript{119} Id.

\textsuperscript{120} Letter from Lawrence H. Summers, Deputy Sec’y, Dep’t of Treasury, to Sen. Daniel Patrick Moynihan, at http://www.treasury.gov/cc/071598.htm (July 15, 1998).

\textsuperscript{121} Schwartz, supra note 74, at A4 (quoting Gov. Gilmore, "I want to decriminalize the American people who are buying goods and services over the Internet.").

\textsuperscript{122} See ACEC REPORT TO CONGRESS, supra note 23, at 4–6. The issue areas that received more than two-thirds support were: 1) digital divide; 2) privacy implications of Internet taxation; and 3) international taxes and tariffs. Issue areas receiving only majority support were: 1) sales and use taxes; 2) business activity taxes; 3) Internet access; 4) taxation of telecommunications services and providers; 5) international
taxes and tariffs; and 6) the need for improved knowledge of international ramifications. Id.

\textsuperscript{123} See generally Matthew Vadum, Internet Taxation Bill Stalled in House Subcommittee, THE BOND BUYER, May 18, 2000, available at 2000 WL 5811925. Vadum reported that:

A House bill that would enshrine into law some of the recommendations of the Advisory Commission on Electronic Commerce regarding Internet taxation is going nowhere for the time being. After yesterday’s rancorous hearing before the House Judiciary Committee’s commercial and administrative law subcommittee, [C]hainman George Gekas, R-Pa., said the bill was ‘nowhere near’ a markup because both backers and opponents of the bill need more time to present their views to his panel.

\textsuperscript{124} See generally 2000 Internet Taxes: Hearing on H.R. 4267, H.R. 4460, and H.R. 4462 Before the House Subcomm. on Commercial and Administrative Law, Comm. on the Judiciary, 106th Cong. (2000) (statement of Gary Viken, Sec’y South Dakota Dep’t of Revenue and 1st Vice President, Fed’n of Tax Adm’rs). Sec’y Viken noted that:

[Forty-two governors have written to the leadership of the Congress asking that they reject the Commission report. More than 100 academic economists have also signed a letter criticizing the report as reflecting inappropriate and misguided tax policy . . . The Report of the Advisory Commission on Electronic Commerce unfortunately, in the opinion of most state and local officials, does not further the goals of sound tax policy and administration in this area. Instead, it contains recommendations for substantial preemption of state tax authority that are not only detrimental to the fiscal position of states and localities, but will likewise cement into place the unlevel playing field facing fixed-base retailers and other current taxpayers.]

\textsuperscript{121} Id.
tion in the near future on the Commission’s recommendations are dim.125 Additionally, prospects for congressional action on a bill reflecting the position of the states are dim.126

1. Confusion to the Masses

The Internet tax moratorium included in the Internet Tax Freedom Act is not a moratorium on all taxes.127 Rather, it is a moratorium on new or discriminatory taxes.128 Accordingly, those protecting the states’ interests (i.e., to retain or expand transaction tax collection authority) did not view the moratorium as discriminatory treatment advantaging the Internet retailer at the expense of the brick-and-mortar retailer.129 Conveniently, however, there is great confusion as to what is and is not covered under the moratorium.

As previously discussed, the 1996 Act did not classify the Internet as a telecommunications service. Nonetheless, prior to the Internet Tax Freedom Act, twelve states and the District of Columbia imposed a similar transaction tax on Internet access as that imposed for telephone service.130 As such, the primary target of this moratorium was a “tax” on Internet access.131 There are a variety of additional assessments—either a fee or a tax—that appear on the consumer’s telephone bill. Ironically, the access charge132 imposed on long-distance carriers is not a tax at all. At the federal level, there is imposed a 3% excise tax on all telecommunications services.133 Most states also charge an excise tax at this same base. Not to be confused with a tax, however, is a fee known as the E-rate.134 The E-rate is imposed on long-distance carriers to provide schools, libraries and rural health care centers with telecommunication services, wiring and computer equipment. Finally, universal service to all customers regardless of location is funded through “access charges” imposed on long-distance carriers.135 These access charges have received little attention even though they served as the impetus for the Internet Tax Freedom Act.

2. Parity for the Internet and the Brick-and-Mortar Retailer

What does nondiscriminatory mean? In its testimony before Congress, the administration made clear that it did “not want duplicative, discriminatory or inappropriate taxation by thousands of different state and local tax jurisdictions to stunt the development of what President Clinton . . . called

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125 See generally Robert MacMillan, Nat Tax Group Bemoans Sen. Dorgan Bill, Newsbytes, June 27, 2000, available at 2000 WL 2117921 (reporting that “[w]hile the House of Representatives passed that measure, it has been held up in the Commerce Committee, with Chairman John McCain, R-Ariz., unwilling to hold a vote on the bill because of widespread opposition to keeping e-commerce outside of any possible local taxation”).

126 See id.

[S]en. Dorgan’s bill, S. 2775, fulfills a long-awaited promise he and other Senate Commerce Committee members made to state and local governments to try to devise a bill that would prevent unfettered Internet taxation while at the same time calling for those states and localities to simplify their tax systems to make it possible to collect some revenues from online transactions.

Id. Sen. Dorgan’s bill resembles a bill introduced by Sen. Dale Bumpers in 1994, infra note 175. Supporters of the bill include the Multi-state Tax Comm’n, the Fed’n of Tax Adm’rs, the Nat’l Governors Ass’n, the Council of State Gov’ts, the Council of Chief State School Officers, the Int’l Council of Shopping Centers, the Int’l Mass Retail Ass’n, the Nat’l Retail Fed’n, the Real Estate Roundtable and the E-Fairness Coalition (made up of retailers). Robert MacMillan, Nat Tax Group Bemoans Sen. Dorgan Bill, Newsbytes, June 27, 2000, available at 2000 WL 21179216.


128 See id. at § 151(a) (“No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending 3 years after the date of the enactment of this Act—(1) taxes on Internet access . . . (2) multiple or discriminatory taxes on electronic commerce.”).

129 See Duncan Statement, supra note 82, at 52.

130 See ACEC REPORT TO CONGRESS, supra note 23, at 23.

131 See Duncan Statement, supra note 82, at 52 (noting that “[t]he primary current tax at issue in this legislation is the imposition of state and local sales and use taxes on charges for Internet access and online services.”; see also 47 U.S.C. § 151(e)(3)(D). Section 151(e)(3)(D) states:

The term ‘Internet access’ means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers. Such term does not include telecommunications services.

Id.

132 See generally Henk Brands & Evan Leo, The Law and Regulation of Telecommunications Carriers 693 (1999). Access charges are defined as “charges that long-distance carriers must pay for their use of the local-exchange network in connection with long-distance service. Interstate access charges are regulated by the FCC; intrastate access charges are regulated by the states.” Id.


the most promising new economic opportunity in decades.\textsuperscript{136} The Administration's key objectives [we]re no new Internet taxes and neutrality in taxing electronic commerce.\textsuperscript{137}

Regarding taxation of the Internet, the Treasury Department promoted the tax policy principles used in other areas. Specifically, Internet tax policy based on neutrality, fairness and simplicity\textsuperscript{138} serves to encourage economic activity.\textsuperscript{139} For purposes of the Internet, the primary principle, however, should be neutrality.\textsuperscript{140} Economically similar income should be treated equally under the tax system.\textsuperscript{141}

Ideally, tax rules would not affect economic choices about the structure of markets and commercial activities. This will ensure that market forces alone determine the success or failure of new commercial methods. The best means by which neutrality can be achieved is through an approach that adopts and adapts existing principles in lieu of imposing new or additional taxes.\textsuperscript{142}

Neutrality is not only the resounding theme of the administration, but it is also the approach of many states and other countries. Governor Michael Leavitt (R-Utah) stated it simply: "Do we create a permanent special privilege for a group of shoppers who will not be required to support our schools, our roads and law enforcement? Or do we have a level playing field where everyone is treated the same?" The international community, through the European Union and the Organization for Economic Cooperation and Development ("OECD"), also views a fair, nondiscriminatory and predictable tax system as a priority for transaction taxes.\textsuperscript{143} Further, certain businesses recognize that it is not rational economic or tax policy to provide special treatment to one group of retailers to the detriment of others.\textsuperscript{144} In fact, it is not difficult to imagine the complexity of a tax system that treats one group of retailers differently—thus forcing consumers to know and understand the differences, and tax administrators to administer and enforce the law differently. The reliability of such a system as a revenue source is jeopardized\textsuperscript{145} because businesses will migrate to a less burdened medium. Currently, the Internet serves as a less burdened medium for that retailer not having a taxable nexus in most states. Transactions purchased through the Internet medium are, however, still subject to a transaction tax. Parity for the Internet and the brick-and-mortar retailer is the only equitable approach for sound tax and economic policy.\textsuperscript{146}

B. Congress and the States: Is there a Will for a Way?

1. Political Process Does Not Support Uniformity

Because current law treats all transactions, regardless of the medium, the same for purposes of the transaction tax, the difficult resolution to the Internet transaction tax debate is the need for uniformity in collection. Mancur Olson used economic analysis to prove that opposing forces are not strong enough to counter individual interests in all aspects of life—not the least of which is politics.\textsuperscript{147} As such, when faced with legislative changes, the special interest groups will prevail, absent special arrangements.\textsuperscript{148} Machiavelli explained the difficulty of change by the human nature to distrust new things.\textsuperscript{149} Olson, however, adopts a less sinister and more rational explanation for why change occurs or, more likely, why change does not occur. When change does occur, however, it is typically a change that is inefficient

\textsuperscript{136} Internet Tax and Trade Issues: Hearing on S. 442 and H.R. 4105 Before the Senate Comm. on Finance, 105th Cong. 59 (1998) (statement of Joseph H. Guttentag, Dep't of Treasury Deputy Assistant Sec'y (Int'l Tax Affairs)).

\textsuperscript{137} Id. at 60.

\textsuperscript{138} However, these are at times competing goals—especially simplicity coupled with neutrality or fairness.

\textsuperscript{139} See generally TREASURY PAPER, supra note 6, at 3 n.1.

\textsuperscript{140} The Treasury Report was "limited to federal income taxation issues. These technological developments also raise other issues, such as the effect on subfederal taxation, which are outside the scope of this paper. Nevertheless, Treasury believes that these new technologies should not be used to justify new taxes." Id.

\textsuperscript{141} See id. at 19.

\textsuperscript{142} See id.

\textsuperscript{143} Schwartz, supra note 74, at A4.

\textsuperscript{144} See SIMPLIFICATION, supra note 75, at 2 (citing Outline of Intervention by Stephen Bill to the OECD Forum on Electronic Commerce in Paris (Oct. 12-13, 1999)).

\textsuperscript{145} See id. at 5.

\textsuperscript{146} See id.

\textsuperscript{147} See id.

\textsuperscript{148} See generally OLSON, supra note 36.

\textsuperscript{149} See id. at 18.

\textsuperscript{150} See id. at 38 (quoting NICCOLO MACHIAVELLI, THE PRINCE 51 (1961) ("There is nothing more difficult to arrange, more doubtful of success, and more dangerous to carry through, than to initiate a new order of things... Men are generally incredulous, never really trusting new things unless they have tested them by experience.").
for society as a whole and benefits only a few because of the special interest groups' dominance in the process.

Rational individuals will often act in their own interest before that of a group interest because any gain from an individual's sacrifice for the "common" purpose is shared with everyone in the group. This analysis leads to the conclusion that if greater numbers of individuals benefit from a public (common) good, "in the absence of selective incentives, the incentive for group action diminishes as group size increases, so that large groups are less able to act in their common interest than small ones."152

[Consequently,] a society that would achieve either efficiency or equity through comprehensive bargaining is out of the question. Some groups such as consumers, taxpayers, the unemployed, and the poor do not have either the selective incentives or the small numbers needed to organize, so they would be left out of the bargaining. It would be in the interest of those groups that are organized to increase their own gains by whatever means possible. This would include choosing policies that, though inefficient for the society as a whole, were advantageous for the organized groups because the costs of the policies fell disproportionately on the unorganized . . . There will be no countries that attain symmetrical organization of all groups with a common interest and thereby attain optimal outcomes through comprehensive bargaining.153

Olson further explains that:

[T]he typical organization for collective action within a society will, at least if it represents only a narrow segment of the society, have little or no incentive to make any significant sacrifices in the interest of the society; it can best serve its members' interests by striving to seize a larger share of a society's production for them . . . [T]here is . . . no constraint on the social cost such an organization will find expedient to impose on the society in the course of obtaining a larger share of the social output for itself.154

Compulsory taxation, through which governments redistribute wealth for the benefit of everyone in society, is a "special arrangement" to protect the funding of common goods from the special interests.155 Other groups may be fortunate enough to have "incentives . . . that appl[y] selectively to the individuals depending on whether they do or do not contribute to the prov-

151 See Olson, supra note 36, at 18.
152 Id. at 31.
153 Id. at 37.
154 Id. at 44.
155 See id. at 20.
156 Id. at 21.
157 See id. at 47.
158 McLure, supra note 69, at 7.
159 Walter Hellerstein, Taxing Electronic Commerce: Preliminary Thoughts on Model Uniform Legislation, 75 Tax Notes 819, 820, 822 n.35, 826 (May 12, 1997). The Uniform Commercial Code has been adopted by all 50 states. However, the Uniform Division of Income for Tax Purposes Act ("UDITPA") has only been adopted in 23 of the 46 states imposing a corporate income tax. Id.
160 NTA, supra note 70, at i.
tions, and academia who share an interest in identifying possible solutions to the state and local tax issues raised by electronic commerce."\footnote{161} NTA made broad recommendations but could not agree on more specific recommendations. Nor could the Commission reach agreement.\footnote{162}

Nonetheless, the administration called for states and localities to develop a simplified transaction tax system "within two years."\footnote{163} Recently, 35 state officials met to study simplification and develop model legislation for uniformity by January 2001.\footnote{164} Such a group, composed of only state officials, applying Olson’s economic analysis, holds more promise for recommendations benefiting all of society. However, by not including the other interested parties—such as Internet providers, Internet retailers and brick-and-mortar retailers—the recommendations, once made, face a difficult time in the legislature where those excluded special interest groups make financial contributions to influence policy-makers. Olson’s proposition explains the inability of all these groups and any future groups to reach agreement and thus make recommendations on the details of a uniform system.\footnote{165}

\section*{3. Congressional Mandates Requiring State Action or Inaction}

Under the Constitution, states and the federal government enjoy dual sovereignty.\footnote{166} The power of a state to impose and collect taxes is at the heart of state sovereignty and must not be unduly curtailed.\footnote{167} As such, Congress has at times limited the states’ powers of taxation.\footnote{168} In 1998, Congress again preempted state sovereignty with the Internet Tax Freedom Act.\footnote{169}

Congressional limitations on state sovereignty and ability to raise revenue come at a time when Congress is mandating greater responsibilities on the states.\footnote{170} Congress has the authority, however, not only to limit state taxation under the negative commerce clause, but also to "proscribe state laws on its own views of policy, based on its own considered judgment of fairness and equity."\footnote{171}

\subsection*{4. The Bumpers’ Bill}

Under Quill, “Congress is now free to decide whether, when, and to what extent the States may” require out-of-state retailers to collect trans-

\footnote{161} See id.
\footnote{162} See ACEC REPORT TO CONGRESS, supra note 23, at 19. The Commission was unable to even reach the two-thirds necessary to recommend to "[e]ncourage state and local governments to work with and through NCCUSL [National Conference of Commissioners on Uniform State Laws] in drafting a uniform sales and use tax act within three years after the expiration of the current Internet Tax Freedom Act moratorium (i.e., by [Oct.] 21, 2004) that would simplify state and local sales and use taxation." Id.
\footnote{163} Alison Bennett, Administration Urges States, Localities to Simplify Tax System in Two Years, BNA DAILY REPORT FOR EXECUTIVES, Mar. 21, 2000, at GG2–3.
\footnote{164} See Schwartz, supra note 74, at A4 (“Once we get it with 10 or 12 states, we think the other states will get on pretty quickly.” (statement of Ray Scheppach, Executive Dir. of the Nat’l Governors’ Ass’n)).
\footnote{165} See NTA, supra note 70, at 18 (“Because of the inability of the participants to agree on . . . simplification and ‘spillover’ [i.e., that any decision impacts treatment of other taxes], however, the Project’s participants could not agree on a new standard.”).
\footnote{166} See U.S. CONST. art I, amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”).
\footnote{168} See generally NTA, supra note 70, at 50–51. In ISTEA, Congress mandated participation by the states in a system that started as a voluntary agreement by the states known as the Int’l Fuel Tax Agreement (“IFTA”). The mandate provided a five-year phase-in period until Sept. 30, 1996. At which time, the states were prohibited from imposing a fuel tax if the state was not participating in a base state agreement, which required single filing of return information and revenue apportionment. The results speak for themselves. Ten states were part of the 1991 voluntary agreement. By 1996, however, all states except Hawaii and Alaska were part of the mandated voluntary agreement. Id.
\footnote{169} See Kaye, supra note 167, at 179–81.
\footnote{170} See id. at 151 (noting that the Americans with Disabilities Act required the states to make handicap accessible sidewalks without funding this mandate).
In 1994, Senator Dale Bumpers (D-AR) accepted the Supreme Court's invitation to update the Commerce Clause with the introduction of The Tax Fairness for Main Street Business Act of 1994. The Bumpers' bill authorized the states to require interstate use tax collection, protected affected companies against unreasonable compliance burdens and insured that state governments distributed the appropriate amount of resulting revenues to their local jurisdictions.

Essentially, Senator Bumpers recognized the inequity that Quill caused in the marketplace. Companies such as Quill refuse to collect, companies such as QVC and the Home Shopping Network voluntarily collect, and brick-and-mortar retailers have to collect transaction taxes. Under the Bumpers' bill, the collection would be mandatory and the playing field leveled. But, falling to the pressures analyzed by Olson, Congress failed to pass the legislation. Although the bill enjoyed the support of the states and localities, it "came under heavy opposition from the direct marketers [and] was characterized as a 'new tax,' . . . [that would] hurt the economy [and] complicate mail-order forms." If opposing forces were strong enough to prevent passage of the Bumpers' legislation, the incredible rise in the use of the Internet offers dim prospects for a different outcome today.

5. Jurisdictional Integration

Olson argues that with "jurisdictional integration" societies expand free trade between the smaller parts of the larger "community," expand the free movement of production components and shift the location of power to make some economic policy decisions. Following jurisdictional integration, Olson notes that there is fairly rapid economic progress.Jurisdictional integration, therefore, (e.g., the Bumpers' legislation) fosters the very things (e.g., economic growth) that the opposing forces argue it would hurt.

An example of jurisdictional integration is the Common Market which provides relatively free trade and movement of production components as well as a shift of authority for tariffs from the separate six nations' capitals to the European Economic Community. The formation of the United States from the thirteen colonies also was the result of jurisdictional integration, creating "an area of free trade and factor mobility, as well as a shift in the institutions that made some of the governmental decisions." The free flow of commerce across the states ef-

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172 Quill, 504 U.S. at 318.
173 S. 1825, 103d Cong., 2d Sess. (1994) (including Section 9 of the Tax Fairness for Main Street Business Act, defining "sales tax" to include use taxes).
175 See S. 1825, 103 Cong., 2d Sess. The Act's language provides that: 1) a destination tax whereby an out-of-state company was required to collect transaction taxes if it solicits business in the taxing state and ships tangible personal property into the taxing state; 2) an exemption for a company if its interstate revenue is less than $3 million; 3) the ability to use a standard local tax rate in lieu of multiple rates; 4) for states to collect and distribute for local jurisdictions prior to receiving expanded collection duty requirements; 5) limitations on tax return filing to no more than once per quarter; 6) for maintenance of toll-free state telephone service; and 7) a distribution formula whereby states must remit local taxes collected from out-of-state companies in the proportion to the local taxes collected from in-state companies. Id.
176 See id. at § 2(5).
177 See id.
179 Id. at 120 ("The adoption of the Constitution did, in
effectively results in a seamless nation for purposes of commerce. Ironically, the United States is again at a point in its history for which the individual policy-makers must recognize the need for another iteration of jurisdictional integration to ensure that the nation continues its economic growth without sacrificing its public goods. Nonetheless, given the perhaps insurmountable problems with legislative change for the common good, can Congress or the state legislatures reach the necessary conclusions? If not, is there an opportunity for the Supreme Court—a small, organized group—to resolve the issue for the benefit of the larger populace?

V. THE AFTERMATH OF—AND A POSSIBLE RESOLUTION OF—THE SUPREME COURT’S DECISION IN QUILL

A. Evolution of the Retailer

Retail business evolution has experienced at least four phases: from the local retailer selling primarily tangible personal goods to local consumers (e.g., traditional brick-and-mortar retailers such as Wal-Mart); to mail-order catalog retailers (e.g., Quill); to the click-and-mortar retailer (e.g., Barnes & Noble with brick-and-mortar stores nationwide and barnesandnoble.com); to the click-and-one-brick retailer (e.g., Amazon.com, with a building in only one state but no physical store presence). The growth in Internet retail opportunities challenges the traditional brick-and-mortar retailers’ ability to reach the ever-expanding client base now available. The holding in Quill encourages brick retailers to enter the "click" market with the same advantages (i.e., no requirement to collect transaction taxes) as the retailers in Quill.

B. Internet Transaction Tax Cases

Contrary to the Court’s expectation in Quill that adhering to the bright-line contemplated in National Bellas Hess would encourage “settled expectations,” the states have been applying alternative nexus theories and are expected to continue these challenges. These challenges have included the technology advances of the Internet. The Internet, which has advanced computer technology far beyond what was imaginable in 1992, is quickly becoming as prevalent as the telephone and the television. "It's becoming our new town

fact, remove tariffs that New York had established against certain imports from Connecticut and New Jersey.


Simons, supra note 73 (“Amazon competitor Borders Group, Inc., of Ann Arbor, Mich., set up Borders Online, Inc. as a separate operation to handle Internet sales. As a result, although Borders Group operates bookstores in all but 10 states, Borders Online charges tax in only two: Tennessee, where it has a warehouse, and Michigan, where it shares a corporate base with Borders Group.”).

386 U.S. at 758.

Quill, 504 U.S. at 316.

See ISA WHITE PAPER, supra note 6, at 217–18.

In SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666, 668–71 (Conn. 1991), Connecticut’s revenue department claimed that, primarily because Saks Fifth Avenue Stamford, Inc. (“Saks-Stamford”) had nexus in the state in the form of the stores that it operated there, its mail-order affiliate, SFA Folio Collections, Inc. (“Folio”), was

required to collect use tax on its taxable sales into the state. The state relied solely on the relationship rather than on any proof that Saks-Stamford was performing any in-state activities on behalf of Folio. The state’s Supreme Court struck the effort down. In Current, Inc. v. California State Board of Equalization, 29 Cal. Rptr. 2d 407, 408–12 (Cal. App. 1st Dist. 1994), the board claimed that, because Deluxe Checkprinters, Inc. had a nexus in the state and because its wholly owned mail-order subsidiary, Current, Inc., sold many of the same items as its parent, the subsidiary was required to collect use tax on taxable sales into the state. The California Court of Appeal ruled against the board. Here the state relied solely on the relationship rather than on any proof that the parent was performing any in-state activities on behalf of the subsidiary. In SFA Folio Collections, Inc. v. Tracy, 652 N.E.2d 693, 695–98 (Ohio 1995), the Ohio Department of Revenue similarly claimed that the out-of-state mail-order seller, Folio, must collect use tax on its taxable sales into the state solely by virtue of its relationship to an affiliate, Saks Fifth Avenue of Ohio, Inc. (Saks-Ohio) that operated stores in the state. In this case, the department relied on a statute specifying that a seller had taxable nexus if it "Maintains a place of business within this state . . . operated by . . . a member of an affiliated group . . . of which the seller is a member . . . ." The state’s Supreme Court ruled that the department’s interpretation of the statute was erroneous and that Folio did not have taxable nexus in the state.

Id.
square, changing the way we relate to one another, the way we send mail, the way we hear news, the way we play.”

C. Amazon.com Is the Transaction Tax Case to Overturn Quill

The purposeful locating of a retailer’s physical facility evidences the depths of behavior encouraged by the inconsistent and unfair application of the Commerce Clause under Quill. Six years ago, Jeff Bezos founded Amazon.com. Within the first three years of operations, Bezos was worth over $2 billion and Amazon.com was the third-largest book retailer in the country. The advances in modern technology that caught Bezos’ attention included the 2,300%-a-year growth in the Internet. Methodically he planned what to sell, where to locate and how to distribute.

He chose books because of the variety of product (more than a million titles in print), because no one merchandiser dominated the market (Barnes & Noble, the largest, had only about a 12% share) and because computers could be very useful in helping customers in ill-defined searches for hazily remembered volumes.

It was the Supreme Court’s holding in Quill, however, that determined the location—or lack thereof—of Amazon.com’s one place of physical presence (i.e., taxable nexus). “California was out because it had too many people—all of whom would have to pay sales tax if they bought any books from an in-state company.” Ultimately, Bezos chose Seattle, Washington. Although Washington has a transaction tax, there are not as many people that would have to pay such tax, and Washington is technology friendly.

While it is predicted that Amazon.com is the Internet’s version of Wal-Mart, there are significant differences to consider. Unlike traditional brick-and-mortar retailers and even mail-order catalog retailers, Amazon.com as a natural result of its Internet existence, has lower costs (i.e., real estate is minimal compared to its reach to consumers, employees are fewer per consumer and inventory is unnecessary because of just-in-time inventory methods). “As a company, Amazon owns almost nothing—no buildings, no factories, nothing that qualifies as equity in the traditional sense.”

Ironically, for this business, which uses the most sophisticated technology, its “whole purpose is to retrieve something that thrived in the past.” According to Bezos, “I want to transport online bookselling back to the days of the small bookseller, who got to know you very well.” This “retrieval” should include collection of transaction taxes, and “getting to know” the consumer should include asking for a billing address or a shipping address. Amazon.com embodies the incredible advances in computer technology and the ease of interstate commerce through the Internet. Its national presence is comparable to companies that voluntarily collect transaction taxes on all purchases based on the destination address.

One or more of the states or localities, other than Washington, currently imposing a transaction tax could challenge Amazon.com’s failure to collect transaction taxes, making a compelling case that the incredible advances in computer technology, which Amazon.com uses to make book browsing so easy, also makes it easy for Amazon.com to collect transaction taxes. First, Amazon.com knows—or can know quite easily—the consumer’s address. Second, because Amazon.com’s product lines are limited—books, music, videos, tools, electronics and software—the complications associated with variations in the tax

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193 Treasury Paper, supra note 6, at 3.
194 See Technology’s 100 Wealthiest, Forbes ASAP, Okt. 5, 1998, at 51 (reporting that “Jeff Bezos (34) – Holdings 19.8 million shares / $2.14 billion.”).
196 See id.
197 Id.
198 Id.
199 Id.
202 See id. (quoting book publisher Peter Osnos).
203 Id.
204 Id.
205 On Mar. 31, 2000, the author purchased computer hardware from Dell Computers. Dell calculated the sales tax for the destination address, even though Dell has no physical presence in the state. According to the sales representative, the computer calculates the tax automatically based on the destination zip code.
base are diminished significantly. As such, Amazon.com's products will generally be considered the same for purposes of transaction tax imposition (i.e., either a state taxes or does not tax the sale of a book). Amazon.com would have little difficulty tracking which states impose such taxes. Similarly, Amazon.com's technological prowess removes any difficulty in tracking the tax rates imposed by the states.

Confronted with a case involving such an apparent lack of burden, the Supreme Court might find that the Commerce Clause is no longer an impediment to interstate transaction tax collection. Indeed, it is not difficult to imagine the Court developing a test to determine a retailer's transaction tax collection requirements. Such a test might consider the size, product line(s) and technological capabilities of the retailer for the lower courts to use in determining when such collection requirements do unduly burden interstate commerce.

VI. CONCLUSION

The Internet provides the “advances in computer technology” that were missing from the facts in Quill. The world of the Internet takes the words of Justice White, in his Quill dissent, to a new level:

[1] In today’s economy, physical presence frequently has very little to do with a transaction a State might seek to tax. Wire transfers of money involving billions of dollars occur every day; purchasers place orders with sellers by fax, phone, and computer linkup; sellers ship goods by air, road, and sea through sundry delivery services without leaving their place of business. It is certainly true that the days of the door-to-door salesperson are not gone. Nevertheless, an out-of-state direct marketer derives numerous commercial benefits from the State in which it does business . . . and creates the greatest infrastructure burdens and undercut[s] the State’s home companies by its comparative price advantage in selling products free of use taxes, and yet not have to collect such taxes if it lacks a physical presence in the taxing State.

Justice White’s concern with the economic unfairness between in-state and out-of-state retailers created by the majority’s holding contradicts the Court’s reasoning in Complete Auto “that administrative convenience . . . is insufficient justification for abandoning the principle that ‘interstate commerce may be made to pay its way.’” Today, Amazon.com and other Internet retailers reach the consumer with far greater ease across interstate boundaries than at any time in the past. Technology also eliminates the burden of transaction tax collection. Ironically, it is the Supreme Court’s adherence to Quill that results in greater burden on interstate commerce than jurisdictional integration of the transaction tax system.

“Although Congress can and should address itself to this area of law, [the Supreme Court] should not adhere to a decision, however right it was at the time, that by reason of later cases and economic reality can no longer be rationally justified.” A Supreme Court holding overturning Quill’s Commerce Clause limitation and requiring jurisdictional integration, through uniformity and collection requirements imposed on all retailers, is the only way to provide a fair, neutral and simple transaction tax system. A federal mandate of jurisdictional integration will eliminate interstate burdens and foster economic growth for the greater community.

206 Quill, 504 U.S. at 303.
207 Id. at 328–29.
208 See id at 329 (“Also very questionable is the rationality of perpetuating a rule that creates an interstate tax shelter for one form of business—mail-order sellers—but no countervailing advantage for its competitors. If the Commerce Clause was intended to put businesses on an even playing field, the majority’s rule is hardly a way to achieve that goal. Indeed, arguably even under the majority’s explanation for its ‘Commerce Clause nexus’ requirement, the unfairness of its rule on retailers other than direct marketers should be taken into account.”).
209 Id. at 329 (citing Complete Auto, 430 U.S. at 289 n.15).
210 Id. at 333 (White, J., dissenting).