INTERNET TRANSACTION TAXES: THE NEED FOR JURISDICTIONAL 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 compliance 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 taxes 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.

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would later become known as the Internet. The Internet, which initially only connected government with academia, was significantly expanded in 1986 with the development of a high-speed network. This new network expanded and accelerated access. 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.

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

The Internet is not, however, a telecommunications service. The Telecommunications Act of 1996 (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.” 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.” For Internet providers, parity with the telecommunications industry would bring with it the same regulatory standards and tax requirements. 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, 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. 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. Nonetheless, the Internet

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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.”).


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, extending the reach of once only brick-and-mortar retailers. 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.

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. 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. 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." 22

22 See generally Treasury Paper, supra note 6, at 8

Web pages are now supplementing paper catalogs for many mail order companies and wholesalers. These Web pages are similar to pages from a paper catalog, displaying images of the goods and product information. Links to the vendor's inventory control system can make it possible to verify whether the requested goods are in stock. For example, one such [website] is a bookseller that allows customers to search a database of over one million books, searching by either subject or name. It is open twenty-four hours a day and has customers in over [sixty] countries. This [website] does not merely allow customers to select and order books[,] but also recommends related titles and will automatically notify customers when a desired book is published.

Id.

23 See generally Advisory Commission on Electronic Commerce ("ACEC"), Report to Congress 11 n.11, at http://www.ecommercecommission.org/report.htm (Apr. 2000) [hereinafter ACEC Report to Congress] ("The term 'click and mortar' stems from the term 'brick and mortar' and refers to those businesses that conduct business through both a physical storefront and a [website]. ['Brick-and-mortar'] businesses, also known as 'Main Street retailers,' are businesses that only conduct business through physical storefronts.")

24 See ISA White Paper, supra note 6, at 211 ("As increasing numbers of private network companies establish links, called 'gateways,' to the Internet for their private subscriber online services, there is no limit to the extent to which the Internet can expand.").

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. In a mere 3 years, sales increased to $5.9 billion. In 1997, a study estimated that sales would reach $6.6 billion by 2000. Of note, however, is that by 1999, sales doubled from their 1998 levels to $11.04 billion.

In the second quarter of 2000 alone, the estimate of U.S. retail e-commerce sales was $5.5 billion. As a percentage of total retail sales, the $5.9 billion in 1998 accounted for 0.2% of total retail sales. By 2004, these Internet transactions are expected to account for 2.5% of total retail sales.

4. Significant Industry

Some have argued that use of the Internet is insignificant. 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-

25 See generally Dept'Re of Commerce, supra note 20.

26 See id.

27 ISA White Paper, supra note 6, at 210.

28 See id. at 213.

29 Internet Retail Sales in 1999 Expected to Double, Wall St. J., May 18, 1999, at A4 [hereinafter Internet Sales Double].

30 See ISA White Paper, supra note 6, at 213.

31 Internet Sales Double, supra note 29.


33 See Internet Sales Double, supra note 29 (citing a report by the Direct Marketing Ass'n).

34 See id.

35 See ISA White Paper, supra note 6, at 213.

36 A recent survey of households in the United States and Canada revealed that only 17% of individuals over the age of 16 had used the Internet during the previous six months, 13 percent had used the World Wide Web, and only 14% of those users, or 1.8% of the total population[,] had purchased anything over the Web.

Id. (citing CommerceNet/Nielsen Media Research Recontact Study (Aug. 13, 1996)).
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"  

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.  

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." Transaction taxes serve as an important source of state and local government revenue. 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. 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.
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\(^{49}\) and Quill v. North Dakota.\(^{54}\) National Bellas Hess limited the states’ authority to require transaction tax collection based on the Due Process Clause\(^{46}\) 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 recognizing that the Quill Court recognized the evolution of its Commerce Clause jurisprudence,\(^{58}\) with limitations.

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\(^{43}\) 386 U.S. 753 (1967).

\(^{44}\) 504 U.S. 298 (1992).

\(^{45}\) See National Bellas Hess, 386 U.S. at 758; U.S. Const. amend. XIV, § 2.

\(^{46}\) See National Bellas Hess, 386 U.S. at 760; U.S. Const. art. I, § 8, cl. 3.

\(^{47}\) See generally ISA White Paper, supra note 6, at 216 (" ‘Nexus’ means ‘contact.’ For state tax purposes, ‘taxable nexus’ means sufficient in-state contact to subject an out-of-state seller to the taxing jurisdiction of a state. In state tax terms, however, ‘nexus’ is often used to mean ‘taxable nexus.’ ") (citations omitted).

\(^{48}\) See National Bellas Hess, 386 U.S. at 758.

\(^{49}\) See Quill, 504 U.S. at 302.

\(^{50}\) Miller Brothers, Co. v. Maryland, 347 U.S. 340, 344–45 (1954).

\(^{51}\) Quill, 504 U.S. at 307. The Court noted:

Building on the seminal case of Int'l Shoe Co. v. Washington, we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.' In that spirit, we have abandoned more formalistic tests that focused on a defendant's 'presence' within a State in favor of a more flexible inquiry into whether a defendant’s contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State. In Shaffer v. Heitner, the Court extended the flexible approach that Int'l Shoe had prescribed for purposes of in personam jurisdiction to in rem jurisdiction, concluding that 'all assertions of state-court jurisdiction must be evaluated according to the standards set forth in Int'l Shoe and its progeny.'

\(^{52}\) Id. (citations omitted).


\(^{54}\) Quill, 504 U.S. at 308 (citing Shaffer v. Heitner, 433 U.S. 186, 218 (1977) (Stevens, J., concurring)).

\(^{55}\) U.S. Const. art. I, § 8, cl. 3.

\(^{56}\) 303 U.S. 177 (1938).

\(^{57}\) Barnwell Bros., 303 U.S. at 185.

\(^{58}\) See generally Quill, 504 U.S. at 309 ("Our early cases . . . swept broadly, and in Leloup v. Port of Mobile we declared that no State has the right to lay a tax on interstate commerce in any form.") (citations omitted).


\(^{60}\) See Quill, 504 U.S. at 322 (White, J., dissenting) ("In my view, the Court should also overrule that part of Bellas Hess which justifies its holding under the Commerce Clause.").

\(^{61}\) See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274,
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. 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.” 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.” 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.” 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, 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. Localities within the states 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. The result is that a business operating nationally is confronted with 7,600 individual taxing jurisdictions, with over 1,300 in Texas alone. The magnitude of compliance could be even worse if every local government imposed a sales and use tax.

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. 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.

Montana, New Hampshire and Oregon).

66 See AEC REPORT TO CONGRESS, supra note 23, at 17.
69 See Cline & Neubig, supra note 42, at 1.
70 See id.
71 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.”).
72 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.\(^7\) The compliance costs borne by small and medium size retailers would prove to be an unacceptable cost for a tax agency.\(^7\) 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.\(^7\) If a retailer expands operations nationwide, compliance costs jump higher. For a medium retailer, costs jump to 48%.\(^7\) Further compliance with local transaction taxes alone accounts for over 50% of the compliance burden for small and medium size retailers.\(^7\) 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."\(^8\) States must challenge the benefits received (maintaining revenue sources) for the cost (giving up some state sovereignty).

7 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 Dept' 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."\(^9\) 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.\(^9\)

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-
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

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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 McClure, 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 1.
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. 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. 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.

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.” By design, the Internet (and thus the Internet retailer) does not know the location of the consumer. “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.”

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.

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 to bundle taxable and nontaxable goods and services, and to deliver digital products. 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-


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.”).

See ISA WHITE PAPER, supra note 6, at 19.

See generally ISA WHITE PAPER, supra note 6, at 210, 220.

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.”).


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.”).


107 See generally SIMPLIFICATION, supra note 75, at 4 n.5. [N]on-uniformity is the technology obstacle, not the number of taxing jurisdictions. If you solve the first, technology exists or can be developed to handle the second . . . . Because it is not cost effective to completely automate the ambiguity inherent in the current sales and use tax system, technology is not a viable solution for the vast majority of Internet vendors without dramatic simplification of the existing system.

Id.

108 See Simons, supra note 73 (“Microsoft Corp. is one of the few companies that regularly factor in state and local sales taxes. As consumers type their addresses on an electronic sales form, the Redmond, Wash., company’s billing system calculates the tax for that location.”).

109 Cline & Neubig, supra note 42, at 20.

110 See McLure, supra note 69, at 4 (“Software would be used (a) to determine the state and local tax rates that should be applied to remote sales of particular products[,] and (b) to prepare the reports containing the information needed by states to channel revenues to the appropriate local jurisdictions.”); see also DATA KINETICS LTD., ADAPTIVE TECHNOLOGY: A FOUNDATION FOR AUTOMATING THE TAXATION OF E-COMMERCE 1, at http://www.dkl.com/dk/pdfs/taxes-whitepaper.pdf (Mar. 10, 1999) (stating a proposal for an Internet-based system that will not burden the merchant, commodate 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 21st 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-

\begin{footnotesize}
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\item[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.").

\item[115] Duncan Statement, supra note 82, at 53.

\item[116] The Nat'1 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 (1998) (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. Micali, Direct Marketing Ass'n) (noting that the Direct Marketing Ass'n opposed a broad mandate of formulating a policy regarding interstate sales tax collection).

\item[117] See Fendley Interview, supra note 114.


\item[119] Id.

\item[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).

\item[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.").

\item[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.

\item[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]hairman 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.

\item[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 Dept' of Revenue and 1st Vice President, Fed'n of Tax Adm'n's). 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.

\item[125] Id.
\end{itemize}
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tion in the near future on the Commission’s recommendations are dim. Additionally, prospects for congressional action on a bill reflecting the position of the states are dim.

1. Confusion to the Masses

The Internet tax moratorium included in the Internet Tax Freedom Act is not a moratorium on all taxes. Rather, it is a moratorium on new or discriminatory taxes. 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. 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. As such, the primary target of this moratorium was a "tax" on Internet access. There are a variety of additional assessments—either a fee or a tax—that appear on the consumer’s telephone bill. Ironically, the access charge 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. 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. 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. 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 after the date of the enactment of this Act—(1) taxes on Internet access . . . (2) multiple or discriminatory taxes on electronic commerce.")


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125 See generally Robert MacMillan, Net Tax Group Bemoans Sen. Dorgan Bill, NEWSBYTES, June 27, 2000, available at 2000 WL 2117921 (reporting that "[t]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, Net 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
the most promising new economic opportunity in decades."

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 serves to encourage economic activity. For purposes of the Internet, the primary principle, however, should be neutrality. Economically similar income should be treated equally under the tax system.

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.

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. 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. 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 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.

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. As such, when faced with legislative changes, the special interest groups will prevail, absent special arrangements. Machiavelli explained the difficulty of change by the human nature to distrust new things. 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

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)).

137 Id. at 60.

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

139 See generally TREASURY PAPER, supra note 6, at 3 n.1. 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.

140 See id. at 19.

141 See id.

142 See id.

143 Schwartz, supra note 74, at A4.

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)).

145 See id. at 5.

146 See id.

147 See id.

148 See generally OLSON, supra note 36.

149 See id. at 18.

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:

[The] 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 provision of the collective good."156 The confusion surrounding the Internet transaction tax debate produces the former large groups of rational individuals to mistakenly believe that there is no transaction tax on Internet purchases. These individuals do not intend to "sacrifice" for the common good by supporting a transaction tax on Internet purchases. Conversely, current law supports the latter. Transactions on the Internet are subject to transaction taxes. Given such a "special arrangement," legislators should support uniformity for collection. In the end, the result is reduced efficiency, wealth aggregated in a few and increased political divisiveness.157 The Internet transaction tax debate provides a quintessential example of all of these negative outcomes.

2. Can Voluntary Cooperation Achieve Complete State Uniformity?

A cooperative effort without a federal mandate to develop and implement a uniform system of assessing and collecting transaction taxes by all states and localities does not sound like an unreasonable or virtually impossible task—but it is. "In fact, history does not inspire confidence that the state[s] would act in this way."158

The states provide examples of cooperative efforts aimed at uniformity that have not necessarily achieved adoption or uniformity.159 With the rise in Internet transactions, the states have again attempted to reach uniformity. The National Tax Association Communications and Electronic Commerce Tax Project ("NTA") was formed "to develop and implement a uniform system of assessing and collecting transaction taxes."160 NTA membership offered balance to the views of the interested parties by bringing "together the business community, state and local governments, professional organiza-

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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.”

NTA made broad recommendations but could not agree on more specific recommendations. Nor could the Commission reach agreement.

Nonetheless, the administration called for states and localities to develop a simplified transaction tax system “within two years.” Recently, 35 state officials met to study simplification and develop model legislation for uniformity by January 2001. 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.

3. Congressional Mandates Requiring State Action or Inaction

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

Congressional limitations on state sovereignty and ability to raise revenue come at a time when Congress is mandating greater responsibilities on the states. 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.”

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-

161 See id.

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 “[c]ourage 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.

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.

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)).

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.”).

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.”).


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 use 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.

169 See id. at 151 (noting that the Americans with Disabilities Act required the states to make handicap accessible sidewalks without funding this mandate).

action taxes. 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 incred-

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172 Quill, 504 U.S. at 318.
173 S. 1825, 103rd 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.
178 See Schwartz, supra note 74, at A4. The author explained that Gov. Michael Leavitt (R-UT): [N]ot only doubts that the Gilmore commission will take a strong stand, he predicts that Congress will not take up such a thorny issue in an election year. That means the issue will continue to percolate without resolution through the next election. But it will surely return with the Christmas shopping season, which promises to pump billions of dollars more into Internet commerce. When that happens, traditional retailers will turn to Washington, Leavitt predicted: 'They're going to storm Capitol Hill with one phrase on their lips: 'level playing field.' "
181 Fendley, supra note 174, at 5–6.
182 The term "free trade" should not be confused with "no-tax." Free trade, instead, refers to ensuring that a tariff placed on one competitor is also placed on another (or not placed on either) regardless of the location of the sale and the destination of the good.
183 See OLSON, supra note 36, at 121.
184 See id.
185 See id. at 119.
186 See id.
187 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.".


189 See 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.”).

190 386 U.S. at 758.

191 Quill, 504 U.S. at 316.

192 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.” Yet Amazon.com is as branded in our minds as Xerox or Kleenex.

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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195 Treasury Paper, supra note 6, at 3.
196 See id.
197 Id.
198 Id.
199 See id.
200 See George Anders, Cybersqueeze, Comparison Shopping Is the Web’s Virtue—Unless You’re a Seller: Amazon.com, Others Face Weak Pricing and Losses Even as Their Stocks Soar: Can a Fifth Avenue Developer?, The Wall St. J., July 23, 1998, at A25 (quot-
Internet Transaction Taxes

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] creat[es] 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).