

New Proposals to Tax the Internet

2000-2

by Richard A. Derham, President

Introduction

By enacting Initiative 695 in November 1999, Washington voters declared themselves to be overtaxed and not willing to take it anymore. Not only did they reduce state taxes by \$750 million a year, the largest tax cut in state history, by repealing the Motor Vehicle Excise Tax (MVET), but they determined that all future tax increases must be referred to a public vote.

One week later, the National Governor's Association (NGA), the National League of Cities, the Council of State Governments and other organizations representing the tax spenders of the nation, floated a proposal to increase taxes on Washington citizens and those of other states by creating a "voluntary" tax on Internet sales.

A voluntary tax. What a concept!

Some background

Commerce conducted over the Internet, known as e-commerce, is transforming commercial enterprises both retail and wholesale. Barely a glimmer in 1995, e-commerce is now world-wide in scope. Names like Amazon.com, Egghead.com, Drugstore.com and Homegrocer.com are quickly becoming broadly established with the consuming public. According to some estimates, e-commerce already exceeds \$150 billion in annual sales volume.

Aware that the nascent e-commerce industry could lead to a jumble of ill-thought regulations and taxes at many levels of government, Congress in 1998 imposed a moratorium on new taxes on Internet transactions and established a 19-person Advisory Commission on Electronic Commerce. The Commission is to report its recommendations to Congress and the nation later this year. Washington's Governor Gary Locke serves as one of three state governors on the panel.

According to current estimates by Ernst and Young, if annual Internet sales were taxed, state and local governments would receive \$170 million in increased revenues nationally. To governments, this represents "lost revenue;" to consumers, taxing Internet sales is simply a tax increase.

The National Governors Association Proposal

The NGA's proposal would establish what they describe as a "voluntary system" that provides "vendors with a burdenless system of collecting sales taxes...." The NGA simply assumes that Internet shoppers owe sales taxes (or what states like Washington call "use" taxes) on the products they buy. The NGA wants all e-commerce retailers to "voluntarily" collect a tax on every sale. They would then send the taxes to a "trusted third party," a private company

under contract to act as a tax collector for state governments.

Is this an end run around Initiative 695? Some argue that it is. Washington residents now pay no sales tax on mail-order catalogues or Internet purchases from sellers in other states. The NGA proposal would add 8% to the cost of such transactions. As the Washington Times recently editorialized:

“It is perhaps inevitable that whenever money changes hands, politicians will want a share of it, which is why they are now at the cyber gates demanding to be let in.”

The e-Freedom Coalition’s Proposal

An alternative proposal has been developed by the e-Freedom Coalition, a group of more than thirty public policy and consumer groups, including the Washington Institute Foundation. It bases its proposal on several principles: (1) government-imposed barriers to Internet access should be torn down and future barriers prohibited; (2) consumers and businesses deserve a simplified tax code that is “usable, easy to understand and imposes the lowest possible tax burden on consumers;” and (3) consumer and taxpayer privacy should be protected.

Highlights of the e-Freedom Coalition proposal include:

- Repeal the 3% ‘luxury tax’ on telephone service. Enacted in 1898 to finance the Spanish American War at a time few people owned phones, this regressive tax now raises \$4.5 billion a year and affects virtually all Americans.
- Make the moratorium on Internet access taxes permanent. The

explosion in Internet technologies and the likelihood that telephone, cable and wireless services may soon merge to form one vast communication network reaching into every home make any such tax a hidden tax on all citizens.

- Make permanent the moratorium on taxes on Internet sales. Contrary to the NGA proposal, the e-Freedom Coalition would prohibit the extension of sales and “use” taxes to interstate sales made via the Internet. Critical to this proposal is establishing a clear definition of “nexus,” the relationship between a seller and a state sufficient to justify imposing taxes.
- Protection of consumer privacy. Taxation requires data collection. The concept that some national “third party” would compile data on each consumer transaction is troublesome. Whether the seller is Amazon.com or Victoria’s Secret, many citizens prefer not to have government compiling a list of their purchases. The e-Freedom Coalition wants to prohibit any data collection by government beyond the absolute minimum required for calculating taxes.

The comment period before the Advisory Commission presents its report remains open. Comments to the Federal Advisory Commission may be sent to **comments@ecommercecommission.org** and to Governor Locke at Governor’s Office, Legislative Building, Olympia WA 98504. For the complete proposal of the National Governor’s Association see **nga.org/internet/ proposal.asp**; for the e-Freedom Coalition proposal, visit **www.e-freedom.org**.