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WHY CONGRESS SHOULD COUNTER EFFORTS TO TAX INTERNET COMMERCE

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The Internet Tax Freedom Act of 1998 (ITFA) established an Advisory Commission on Electronic Commerce to study the feasibility of taxing electronic transactions done via the Internet. The Commission's recommendations on the critical issues of electronic commerce and tax policy are to be submitted to Congress no later than April 2000. Although a formal plan has not yet been adopted by the Commission, early proposals by some of its 19 congressionally appointed members support a pro-tax system for Internet and electronic transactions.

These proposals are raising concerns in the Internet-based business community and on Capitol Hill that the Advisory Commission is moving to adopt a burdensome new regime for taxing electronic commerce without considering the repercussions that the new taxes would have. Moreover, some Members of Congress are suggesting that the Advisory Commission has incorrectly interpreted its charter under the ITFA. A September 14 letter from House Majority Leader Richard Armey (R-TX) and 35 Republican cosigners to the Advisory Commission expressed their concern "that most of the news reports from the first Commission meeting seemed to focus on how to tax the Internet, rather than *whether* to tax the Internet."

In the Senate, similar concerns have led to the introduction of two bills that would make permanent the current three-year moratorium on Internet

taxes the ITFA put in place. These actions, coupled with the House letter, send a clear message: *There is no congressional mandate to tax the Internet.* Congress should ensure that this important new medium is not subjected to discriminatory and potentially unconstitutional state and local taxes.

The "Lost Revenue" Myth. During recent Advisory Commission meetings, many of the Commission's members showed their pro-tax bent. Some appear to be working under the assumption that the need to tax the Internet is a foregone conclusion; all that remains is to develop the proper mechanism to do so. Fear of lost state and local sales-tax revenue appears to drive the pro-tax agenda within the Commission, whose members include governors and mayors. They fear the impending demise of their budgets and state and local tax bases if electronic commerce is not taxed, or taxed later rather than sooner.

However, even without Internet taxes, state and local governments are collecting record tax reve-

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nues. According to a recent *Investor's Business Daily* editorial, state revenues grew 227 percent and local revenues grew 193 percent between 1980 and 1995. In fact, state tax revenues grew at almost twice the rate of inflation between 1992 and 1998, according to fiscal policy analysts Dean Stansel and Stephen Moore of the Cato Institute in Washington, D.C. In their recent study, "The State Spending Spree of the 1990s," they concluded that, "Today, almost without exception, state governments are awash in tax revenues." And Michael Flynn of the American Legislative Exchange Council agrees. In a new study on "Surplus Revenue in the States," he notes that states are "in their best financial health in over a decade" with \$74 billion in windfall surplus tax revenues over the past four years.

The rise of untaxed electronic commerce helped to generate much of the additional tax revenue for every level of government because the Internet has helped create new business, new industry sectors, and new high-paying jobs in the states. The Advisory Commission could slay the "goose with the golden egg" through a confusing and overlapping array of state and local Internet taxes. Far from promoting economic growth and expanding state and local tax bases, taxing the Internet would reduce and weaken these efforts.

Since Congress established the Advisory Commission, it should monitor its work and ensure that it carries out its ITFA mandate to examine "the effects of taxation, *including the absence of taxation*, on all interstate sales transactions, including transactions using the Internet, on retail businesses and on State and local governments..." (emphasis added). The purpose of the Commission is to *advise* Congress, so Members of Congress should have no qualms about reminding the Commission that it must not treat lightly or overlook any of the possible legislation options, including preserving the current non-tax status afforded Internet commerce.

Restraining a Pro-Tax Commission. Regardless of the Commission's final recommendations, Congress ultimately determines tax policy. So, it will determine future tax policy regarding Internet and electronic transactions. As Majority Leader Dick Armey

and the 35 cosigners in the House stated in their letter, "The Commission should remember that only Congress can authorize one state to compel sellers in another state to collect Internet taxes. This idea is not a popular one in Congress or among the American people. You should know that there are many Members that will oppose any new taxes on the Internet."

Two options would preserve the non-tax status of Internet transactions. The first would keep the Internet free of discriminatory taxes by making permanent the ITFA's three-year moratorium on Internet taxation. Senator John McCain (R-AZ) recently introduced legislation to this end. Senator Bob Smith (I-NH) introduced a similar measure (S. 328) earlier this year.

A second option would be for Congress to codify existing Supreme Court decisions that set the precedents in this area. In *National Bellas Hess v. Illinois* (1967), *Complete Auto Transit, Inc. v. Brady* (1977), and *Quill v. North Dakota* (1992), the Supreme Court essentially forbade states from attempting to tax out-of-state commerce, which the Court deemed unconstitutional.

In the meantime, Congress should remind the Advisory Commission that it is obligated to consider all its members' initiatives, including anti-tax proposals. For example, Commission member Dean Andal, vice chairman of the California State Board of Equalization, has introduced a detailed plan that seeks to clarify existing federal tax policy and limit state tax authority to cases in which a business has a "substantial physical presence" in a state. The Andal proposal also defines when that test would be satisfied.

Considering such constructive proposals would help put the Advisory Commission back on track to recommend how best to preserve existing state and local taxing authority while discouraging burdensome and unconstitutional new taxes on electronic commerce.

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