

One Economist's Perspective on Taxing Electronic Commerce

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Introduction and Disclosures

Earlier Experience with federal grants in aid: federal revenue sharing

Long-time advocate of federal-state tax coordination, piggybacking

Dealt with Carrier Taxes in West Virginia B&O Wars, helped
W. Va. end the B&O tax

Dealt with B&O wars in Washington State, backstopped
Washington Revenue Department in *National Can/Tyler Pipe Case*

Member, Steering Committee Member, NTA Project

Goal is to Provide Broad View of Tax Issues and E-Commerce

Fox-Murray Paper--destination, final consumption tax makes sense, states are entitled to use it, but there are technical problems in administering these taxes in some cases; state and local sales and use taxes should evolve to meet the challenges of electronic commerce;

Peha-Strauss Paper--destination, final consumption tax makes sense, the technical problems may be overwhelming in many cases; state piggybacking of a federal tax may be a more workable answer; ultimately, state and locals may have to consider moving more to income taxes and away from transaction taxes;

Four Questions and Electronic Commerce:

Q1: Why do we tax ourselves to finance government? Anything special about taxing electronic commerce and its proceeds?

Q2: What principles should govern this transformation of private resources to public uses? Are there special conflicts in the case of taxing electronic commerce?

Q3: What's special about electronic commerce in relation to the Big 4 issues of taxes--who, what, when and where?

Q4: What sort of policy movement is there at the federal level, and at the non-federal level?

We tax ourselves:

1. To finance pure public goods which private interests won't produce and finance themselves, e.g. national defense.
2. To finance "mixed" public goods which have some private benefits, and also general benefit, local streets, regional highways, libraries, parks etc..
3. To finance income redistribution (cash assistance to the poor, in kind public services for education, health).
4. To correct market imperfections where private costs not same as public costs (pollution, congestion).

Comment: nothing special here taxing about electronic commerce

Principles usually appealed to when devising taxes:

1. ***Revenue adequacy to the budget.*** Note that states rely on current sales and use taxes a lot; some worry the fiscal sky is falling with electronic commerce through erosion of sales and use tax base.
2. ***Economic efficiency.*** Don't distort consumer and business choices by changing relative prices through taxation if at all possible. Problems arise here with current sales and use taxes.
3. ***Administrative feasibility.*** Taxpayer and tax collector can go about their jobs without undue expenses. Problems arise here, too.
4. ***Enables Redistribution.*** Allows achievement of agreed upon redistribution in terms of:
 - horizontal equity:*** equal treatment of equals
 - vertical equity:*** achieves desired level of progressivity

Some comments on these principles and electronic commerce:

1. State fiscal worry warts: movement to service economy, decline of traditional manufacturing has not been followed by tax base revisions.

Rates have gone up, and the bases narrowed in most states.

2. State sales and use taxes do not honor the economic efficiency principles; anywhere from 35 to 65 % of state sales and use tax bases are levied on business purchases. A no-no from where I sit. US business is more sensitive to this in its tax planning than 10 years ago as the world has gotten more competitive. Or it should be.

3. Transactions via electronic means are growing dramatically, and when the security problem gets solved, they will grow more.

4. Possible *Quill* trade: vendors give up *Quill* victory for simplified system; states get more revenue, business gets reform of cascading.

Three additional principles of taxation often recommended are:

1. The tax should be constitutional to eliminate uncertainty, and needless litigation.
2. The tax should be consistent with fiscal sovereignty of states (and their local governments?)
3. The tax, when applied, should be consistent with the historical privacy of taxpayer-collector relations.

Note:

(1) most agree that, under *Quill*, a state extending the reach of its use tax to interstate (remote) sellers on the Internet is not a sure thing before the courts;

(3) the privacy and record keeping issues are sleepers in the debate

(2) state and local fiscal sovereignty is inconsistent with taxpayer certainty and broad uniformity in our federal system

(3) privacy and sufficient record-keeping to enable state and local audits of customer representations of what transpired are the big sleeper issues in the taxation of electronic commerce.

E-Commerce and Four Tax Questions: Who, What, When and Where

1. Electronic commerce, especially some smart cards, create a real problem for seller and tax collector of knowing who is the purchaser. Obviously law can obligate certain kinds of determinations, including 3rd party determinations. But if seller and buyer wish, they can agree to hide the identity of the buyer, the “Who”.
2. “What” becomes an issue when there is no bill of lading--e.g.. 3rd party (the carrier) verification of what is sent. For tangibles bought over the net, this isn't an issue, it still gets shipped via traditional means. But for services and new intangibles (software), the net doesn't know, and is not likely to easily be able to confirm what is transacting. Do we care? If exemption keys on “Who” we care less for business purposes.
3. “When” is a mess. When the accountants figure out that timing is up for grabs on electronic transactions, there will be real problems.

4. “Where” is the most problematical issue for the states.

A. With a Congressionally imposed duty on interstate vendors to collect use tax, we will have to come to grips with new opportunities for non-compliance:

Will household drop-shipment boutiques sprout up?

Will Oregon figure out that it should become the Delaware of the West Coast, and change its regulatory environment to encourage national banks to offer an Oregon mailing address for all credit cards?

B. What if there is no Congressional imposed duty on interstate vendors to collect a use tax on various kinds of electronic commerce transactions?

Tax Policy Movements at the Federal and Cooperative Levels

Recall 3 approaches to change Federal Policy to Get States and Business in Line (not mutually exclusive):

federal regulatory law-- prohibit certain state actions, permit others;

federal use of *federal spending* to get exact state conformity;

federal tax template through Internal Revenue Code

1. Internet Taxation Moratoria: A Summer of 31 Flavors? Of prohibitions and grandfather clauses:

New House Bill (HR 3529) prohibits taxes on:

- a) Internet access charges
- b) online services
- c) multiple taxes on electronic commerce
- d) discriminatory taxes on electronic commerce
- e) bit taxes (tax on volume of data measured in bits -- a crazy European idea, not implemented in US)
- f) bandwidth (tax on data capacity of electronic highway)

Existing state taxes on electronic commerce are grandfathered if comparable traditional transactions are also taxable;

2. Cooperative Venture: National Tax Association Communication and Electronic Commerce Project.

Process is like Uniform Division development years ago; whether it will work remains to be seen.

Members from industry, government, and “others” (federal representative, AICPA, two academics and one Hoover Fellow).

Objective is to work out model legislation after working out general principles, and areas where agreement and disagreement can be defined. Occurring as Cox-Wyden legislation is being fought out.

Quarterly public meetings, now broken into committees. Adopted Roberts Rules of Order, and voting rules which require 2/3 majority. (Which I voted “pass” on.)

Some initial surprises:

NGA endorsed one tax rate per state;

Some trust developing; distrust still evident between locals and governors.

There seems to be agreement that shipping or billing address should be used, and that inter-state vendors should not have liability for customer's misrepresentations.

Plenty of outstanding issues remain, but there's some good will, and professionalism.

Next meeting is in Los Vegas on July 23 & 24 at same time and place NCSL has its annual meeting. Should be entertaining in one way or another.

Some Concluding Observations and an Idea for Business Taxpayers and their Accountants

1. State sales and use taxes cause lots of economic harm, but mostly academics complain; they are fiscally important to many states.
2. Electronic commerce may become sufficiently large that Congress may act, OR, the states will work out a model set of rules which some parts of business will go along with.
3. But, I doubt inter-state vendors protected by *Quill* will voluntarily collect and remit taxes without federal legislation. Hope I'm wrong here.

The states are not completely defenseless, and the locals are a continuing irritant to business.

4. Revenue effects of not collecting taxes from new, unmeasured markets are hard to estimate, as are the effects of rationalizing and eliminating the hodge-podge of business sales and use taxes.

5. President Clinton wants to enable public school recapitalization, and nothing Ira Magaziner has said precludes a new federal excise. What if no tobacco bill? A federal excise on electronic commerce?

6. Sooner or later we will have to admit that states have a right to audit use tax representations in the electronic area, and then the hard problems of privacy and simplicity in the electronic commerce area will be in front of us. Who will set the standards, and what should they be?

7. Federal promulgation of standards of privacy and information are needed to administer the collection of taxes on electronic commerce; while it seems inevitable, it's hard to find out who's doing it.

8. A truly paperless commercial environment poses challenges to financial measurement and audit more generally than taxation.

9. If state and local sales and use tax revenues truly become visibly eroded as the pessimists surmise, expect income and property taxation to become more prominent than now.

And, an idea for business taxpayers (state and local tax departments) and their accountants:

Obligate suppliers, as a condition of doing business with them, to separately show sales and use tax collected in the transaction, and record this separately in the buyer's general ledger.

Why? It will permit senior management to finally identify how much inappropriate tax they pay on business purchases, and focus their state and local tax departments on what they can save the company. It will create demand for better record-keeping and give the accountants a new software project. It should appeal to fiscal conservatives.

Can Microsoft will lead the way with a new package?

The Microsoft Enterprise Tax Accountant