The Role of Caesar in the Next

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THE ROLE OF CAESAR IN THE NEXT MILLENNIUM?
TAXATION OF E-COMMERCE: AN OVERVIEW AND ANALYSIS

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“Show me the tribute money and they brought unto him a penny. And he saith unto them, Whose is this image and subscription? They say unto him, Caesar's. Then saith he unto them, render therefore unto Caesar the things which are Caesar's....”

I. INTRODUCTION

Since biblical times we have been commanded to render that which was Caesar’s (i.e. taxes) unto Caesar, or the authorities of the moment. Later, we were admonished that the power to tax was the power to destroy. We now accept as a truism that “nothing is certain in life except death and taxes.” As we enter the virtual millennium, death is likely to flourish. As for taxation and the extent which it will affect e-commerce, the jury is still out.

It is well settled that a society cannot prosper economically under an oppressive tax regime. 2 Excessive taxation stifles growth

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1. Matthew 22:21 (King James).
2. Robert N. Mattson, The Sales and Use Tax Dilemma: Multiple Taxation, 52 U.
and distorts economic activity. Taxation of e-commerce is perhaps the most critical concern facing the free market economy in the twenty-first century. The pressing issue is whether cyberspace commerce will be shaped by economic realities or an antiquated tax policy. More aptly, will the taxation of e-commerce impede economic growth?

Internet retail sales are soaring. According to the U.S. Department of Commerce, retail sales over the Internet generated $2.6 billion in 1998. Worldwide it is estimated that consumers spend between eight to thirteen billion dollars on goods over the Internet. As for business e-commerce, estimates indicate that $43 billion in goods were bought in business-to-business e-commerce transactions. Retail sales for 1999 are expected to surpass $30 billion. Some analysts believe that by the year 2002, Internet commerce will account for more than $300 billion of United States Gross National Product. The continued growth of e-commerce is dependent in large measure on the extent to which Internet transactions are free of taxation.

M AMI L. REv. 725, 726 (1998). The author suggests that multiple or overuse of taxation tends to distort economic activity by forcing it to find ways and make structural decisions to avoid the burden. Id.

3. E-commerce is commonly understood to involve commercial transactions such as purchases over the Internet. Electronic fund transfers and credit card transactions are two of the older methods of electronic commerce.


6. Business Topics, SUN-SENTINEL, May 20, 1999, at 3D. The figures of current and projected revenues vary somewhat because there is no consensus as to what is properly classified as Internet commerce. For example, estimates show that E-commerce sales will grow to between $80 billion and $225 billion by the year 2000, with a White House estimate of $300 billion by 2002. John Swartz, E-commerce Is Hottest Thing at Net Show, S.F. CHRON., Mar. 12, 1998, at E1.


8. Internet merchants enjoy a competitive advantage over the local retailers. Growth of e-commerce is due in large part to this advantage. One study suggests "that to apply existing sales taxes to Internet commerce would reduce the number of online buyers by 25% and spending by more than 30% with some specifications suggesting even larger effects." Austan Goolsbee, In a World Without Borders: The Impact of Taxes on Internet Commerce, (Nov. 15, 1998), at http://www.ecommercecommission.org/library.htm.
The problem with taxing e-commerce arises because of the uncertainty of the locale. Whereas taxing normally occurs in the place where the sale is made, with e-commerce there is no place in the traditional sense. On the Internet, services and products are generally sold from remote locations to consumers. In a non-Internet transaction, when the state imposes a sales or use tax, the vendor company faces a sales tax liability for failure to collect and remit to the state the sales tax on out-of-state sales. The vendor receives a gross receipt from the buyer, which represents potential sales tax to the taxing state. Generally, the out-of-state merchant must have a “nexus” or physical connection with the taxing state where the customer is located before it has an obligation to collect and remit the sale or use tax.

Historically, the question of nexus arose in the context of mail-order purchases. Mail order companies include catalog sales, direct marketing, and cable television shopping. Because these vendors have no physical presence in the state of purchase, they generally do not have to collect and remit sales tax. This exemption from taxation allowed the mail order businesses of the 1960s to blossom. Of course, many claim the growth was at the expense of the local main street store and the local jurisdictions that lost revenues. These constituents now have to compete with e-commerce.

The magnitude of e-commerce is prompting attention never afforded the catalog business. The Internet is drastically changing the manner in which commerce is transacted. The traditional notions of physical boundaries and jurisdiction are rapidly becoming obsolete. It appears that our concepts of taxation may have to change as well.

The focus of this paper is the taxability of tangible goods sold over the Internet to consumers. Typically, the merchant offers a


10. It should be noted that there are other businesses in competition with the Internet. For example, the U.S. Post Office will undoubtedly suffer from the no-tax status of the Internet.

11. A substantial amount of e-commerce occurs between businesses. The tax concerns of business-to-business e-commerce differ from consumer purchases. The physical locale or nexus is not at issue because of the parallel use tax structure. Businesses must file sales tax returns. They must also include a use tax on out-of-state purchases if no sales tax was charged. The pressing concern in this
product for sale over the Internet. The shopper accesses the vendor's web page, makes a credit card purchase, and the product is delivered via carrier to the purchaser.\footnote{1706}{Vol. 27:3}

Part I will provide a brief definition, description and history of the Internet. Part II will provide an overview of sales and use taxes. Part III will address the limitations imposed on state taxation by the U.S. Constitution and decisional law. Part IV will discuss the Internet Tax Freedom Act of 1998. Part V will analyze some of the arguments advanced in support of and against taxation of e-commerce. The article will conclude with a recommendation that Congress completely forbid taxation of e-commerce.

II. \textit{Part I: The Evolution of The Internet}

This section traces the history of the Internet and examines its area is tax–pyramiding.

12. An appreciable portion of Internet commerce, however, involves purchases that merely involve the downloading of software. These transactions will not be discussed. The absence of a delivery and a physical product invites a different analysis. Among other things, the traditional definition of sale includes language to include the transfer of title, exchange, barter, license to use, or license. It is not entirely clear what rights are conferred upon a purchaser of software, databases, entertainment, and other digital information via online downloading. These transactions should be afforded a separate model. They exist entirely on the Internet and require no retail or wholesale infrastructure. The taxability of software depends on its classification as tangible or intangible personal property. State sales tax typically only applies to tangible personal property whereas cases have treated software as intangible for various tax purposes. Subsequently, states have distinguished between canned or prepackaged mass-produced software and software custom made to a particular program. The custom-made software may often be nontaxable service transactions because of the degree of personal services required. Robert L. Cowdrey, \textit{Software and Sales Taxes: The Illusory Intangible}, 63 B.U. L. Rev. 181, 185 (1983). States are increasingly taxing software either by statute or by expanding the definition of tangible property. \textit{E.g.}, Navistar Int'l Transp. v. State Bd. of Equalization, 884 P.2d 108, 111 (Cal. 1994) (holding that secrets embroidered in drawings and designs were tangible property); S. Cent. Bell Tel. Co. v. Barthelemy, 643 So. 2d 1240, 1242 (La. 1994) (holding that all software was tangible property for Louisiana use tax purposes).

Also excluded is a discussion of telecommunications based information services. This includes products and services that are accessible via telephone lines, satellite, and cable personal computers. The primary focus of most state sales tax schemes is on the retail sale of tangible personal property. The digitalization of products such as music compact discs, movies, and various textual and graphical materials has led to the ability to sell and package these items for direct delivery to the consumer over the information highway using telecommunications. The question then becomes whether digital transmission of these products alters their tangible property status.
structure and operation. The current debate on the taxation of sales by out-of-state merchants focuses in large measure on the merchant's physical presence in, or connection with, the taxing jurisdiction. The Internet is a vehicle through which the merchant offers goods and services. Familiarity with the Internet's architecture is critical to understanding the policy of taxing a transaction based on a nexus or a physical presence requirement.

Department of Defense researchers created the Internet in 1969. It was founded as a government online clearinghouse designed to facilitate the free flow of information and exchange of ideas between governmental, educational, and scientific agencies and other entities. Initially, access to the Internet was restricted to government agencies and educational institutions for scientific and academic research.

The Internet may be described as an interconnection between computer networks. The Internet is more of a process or event than a tangible object. The foundations for this inter-connectivity are telecommunications and a set of common languages or protocols that all Internet connected computers have in common. No one owns the Internet. Several companies operate as processors of electronic services and provide user-friendly access to the Internet.

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13. It has been suggested that certain aspects of the Internet network can be traced to the systematic conveyance of messages from ancient Egyptian messengers through modern devices such as the telephone. KATIE HAFNER & MATTHEW LYON, WHERE WIZARDS STAY UP LATE: THE ORIGINS OF THE INTERNET 51-52 (Simon & Schuster 1996).

14. The Internet was developed by the U.S. Defense Department's Advanced Research Projects Agency (ARPA). The aim was to develop a data network that could survive a nuclear attack. ADAM GRIFFIN, EVERYBODY'S GUIDE TO THE INTERNET 16 (1994). Others claim that the initial network was based on peaceful purposes. HAFNER & LYON, supra note 13, at 10. The first network was known as ARPANET. The network connected computers at UCLA and Stanford Research Institute (SRI). Id. at 12.

15. Phil Patton, Life on the Net, ESQUIRE, Dec. 1994, at 131, 138 (describing the Internet and the myriad commercial services available); see also Edward A. Morse, State Taxation of Internet Commerce: Something New Under the Sun?, 90 CREIGHTON L. REV. 1113, 1115 (1997) (comparing the Internet's working concepts with those of the U.S. Postal Service and the telephone system).

16. Internet Tax Freedom Act, Pub. L. No. 105-277, 47 U.S.C. §§ 151-1104(4) (1998) defines "Internet" as "the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected worldwide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio." Id.

and other information services.\textsuperscript{18}

The Internet is easy to access. One can "get on" the Internet either by using a modem that connects the user by way of telephone to a computer directly linked to the Internet or by linking directly to a computer network connected to the Internet. Usually, corporations, governmental agencies, and universities have their own computer networks that are directly connected to the Internet. Individuals using a modem access the Internet by subscribing to ISPs (Internet Service Providers),\textsuperscript{19} or nationwide computer networks that are linked to the Internet. Once on the Internet, a user may engage in remote information retrieval, one-to-one messaging, or real time communication. Remote retrieval of information is usually through the World Wide Web, which is, in brief, a series of documents stored in different computers all over the Internet.\textsuperscript{20} One-to-one messaging is basically electronic mail or "e-mail."\textsuperscript{21} Real time communication is the mechanism that allows users to engage in dialogue (chat rooms) over the Internet.\textsuperscript{22}

The Internet's infrastructure was expanded in the mid-1980s when the National Science Foundation built high-speed long distance phone lines that connected supercomputing centers across the nation. This system replaced the original network known as ARPnet.\textsuperscript{23} In 1991, when the federal government announced it was lifting restrictions, other Internet access providers created their own commercial networks to provide communications access to commerce.\textsuperscript{24} These network access providers are essential to information highway sales because they connect consumers to the core of the information services industry. The structure of these access providers and their relationship to the delivery of information services implicates the determination of nexus. Given the nature of the services and the system that is the conduit for e-commerce, reconciliation of e-commerce taxation based on a physical presence requirement is troublesome.

\textsuperscript{18} Barry M. Leiner et al., \textit{A Brief History of the Internet}, (Nov. 2000), at http://isoc.org/internet/history/brief.html (offering a technical description of the Internet from the perspective of some of its founders).

\textsuperscript{19} The ISP provides space on the computer network that is accessible by others having access to the Internet. In contrast, the Web site or homepage refers to the space provided or to what is seen on the consumer's computer screen.


\textsuperscript{21} Id. at 833.

\textsuperscript{22} Id. at 835.

\textsuperscript{23} Resnick, \textit{supra} note 17, at 112-13.

\textsuperscript{24} Id. at 113.
III. PART II: THE GENESIS AND NATURE OF STATE SALES AND USE TAXATION

Historically governments have taxed sales transactions. Various forms of sales taxes existed in ancient Egypt, Greece, and Rome. Sales taxation in this country is a relatively recent phenomenon; it was not implemented until the Great Depression of the 1930's. Sales taxes were levied to offset the effects of the depression on state revenue collection. Since the depression, they became a permanent part of state budgets. The need for and legitimacy of sales taxation has for the most part not been re-evaluated. Moreover, most of the current tax statutes predate modern technology and e-commerce. Arguably, legislatures could not have intended to tax transactions not in existence at the time of drafting. Of course, it is also possible that states view taxation of sales transactions (notwithstanding their nature) to be both an unqualified right and privileged revenue source.

The modern concept of sales tax includes a variety of assessments on consumer purchases of goods and services. Sales and use taxes are imposed on the transfer of all tangible property and some services. Generally, a retail sales tax is levied upon consumers in proportion to their purchases. The burden to remit the tax is often borne by both the seller and purchaser.

Use and sales taxes are commonly assessed on retail sales of tangible personal property for use or personal consumption. The sales tax is added to the cost of the item and paid to the merchant upon the sale. The consumer pays the tax; the vendor sets the tax aside and remits it to the state.

A use tax is a complement to sales tax rather than being in addition to the tax. The purpose of a use tax, other than to produce

26. Id. Some states, however, do not have a sales tax, for example Delaware, New Hampshire, and Oregon.
27. Id. States receive 34% of their state tax revenue from sales and use taxes.
29. PRENTICE HALL, INC., PRENTICE HALL'S GUIDE TO SALES AND USE TAXES 57 (1988).
31. 2 RESEARCH INST. OF AMERICA, INC., ALL STATES TAX GUIDE, ¶ 5003 (1994).
revenue, is to prevent the evasion of sales tax by purchasing an item tax-free out-of-state. 32 Often, use taxes are referred to as compensating taxes. The validity of the use tax has been upheld under the Commerce Clause because it is levied upon the privilege of use after the goods have left the interstate stream of commerce. 33

Use taxes are imposed upon storage 34 and use 35 of tangible personal property within the state. 36 Ideally, the use tax levels the playing field by giving the local merchant parity with the out-of-state retailer whose goods are not taxed.

Sales and use taxes do not work well in out-of-state transactions. The purchaser from an out-of-state vendor is required to report and submit the tax. Because this method depends on self-regulation, however, it is virtually ineffective. The use tax is generally self-assessed by the purchaser since the vendor will not collect the tax. The user must determine the value and voluntarily pay the tax to the state. In some instances, the out-of-state vendor collects the tax even if it is not required to do so. 37

Use taxes are difficult to implement and provide an excellent example of the bureaucracy inherent in many of the present sale and use tax schemes. 38 The tax statutes usually require consumers to file periodic reports based on the amount of purchases. For example, a Nebraska tax guide informs consumers that they must

32. Id.
33. E.g., Henneford v. Silas Mason Co., 300 U.S. 577, 581-82 (1937) (stating that the right to use is only one of the privileges making up property or ownership, and a state may tax such privileges collectively or lay charge distributively).
34. Storage is generally subject to use tax when property is purchased out of state without tax and brought into the state where the purchaser holds or controls the property and does not intend to resell or hold it for demonstration or display purposes. Robert J. Fields, Understanding and Managing Sales and Use Tax 50 (1994).
35. When property is brought in from out of state, [it] is used prior to being resold, and is not limited to the following: (1) resell or exempt property self-consumed inventory items given away as samples to induce sales; (2) creation or use of self-constructed assets; (3) transfers or sale or property between divisions or subsidiaries of the same parent company...[and] (4) rental of property that does not qualify as a continuing sale, i.e., a true lease sometimes viewed as a sales tax issue when property is rented from an in-state company.
37. Due & MikeSELL, supra note 25, at 257.
submit a form based on the following schedule: if more than $3,000 worth of purchases are made, returns are filed monthly; if purchases range from $900 to $3,000, returns are filed quarterly; and if purchases are less than $900, returns are filed annually. 9

There is no standard generic sales tax concept. Sales taxes fall within one of four categories: (1) privilege taxes; (2) consumer levy taxes; (3) transaction taxes; or (4) gross receipt taxes. An understanding of how each of these taxes operate should precede considerations to tax e-commerce. Selection of the proper tax is critical to the determination of the appropriate taxing jurisdiction. 40

In a privilege tax jurisdiction, the seller is liable for the tax. The seller passes the liability to the purchaser at the time of the taxable transaction. 41 The imposition section of a privilege tax statute typically reads as follows: “[t]here shall be imposed upon each person for the privilege of engaging in the business of selling tangible personal property and taxable services at retail a tax measured by the gross proceeds (receipts) therefrom.” 42 The seller privilege tax states are Alabama, Arizona, California, Connecticut, District of Columbia, Hawaii, Kentucky, Michigan, Missouri, Nevada, South Carolina, South Dakota, Tennessee, and Wisconsin. 43

In a consumer levy jurisdiction, the purchaser is liable for the tax. The seller, however, acting as an agent or trustee for the state or municipality, is responsible for collecting and remitting the tax to the state or local jurisdiction. 44 The imposition section of a consumer levy or excise statute reads as follows: “[t]here shall be imposed upon each sale at retail at the rate of XX% of sales price, a tax collected by the retailer from the consumer.” 45 The consumer levy tax states are Louisiana, Maine, Maryland, Mississippi, Nebraska, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Utah, Vermont, Washington, West Virginia, and Wyoming. 46

In transaction tax jurisdiction, the payment responsibility of the privilege tax and the debt to the seller’s liability of the con-

39. Id. at 1194.
41. FIELDS, supra note 34, at 35.
42. Id.
43. Id. at 41.
44. Id. at 36.
45. Id.
46. Id. at 40-43.
sumer levy tax are combined. A typical imposition of a transaction tax statute is as follows: "[a] tax shall be imposed upon each transaction at the retail at the rate of XX% of the sales price that shall be collected by the retailer from the purchaser." The transaction states are Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Massachusetts, Minnesota, New Jersey, Texas, and Virginia.

The difference between a transaction and the consumer levy is subtle; thus, a company must consider three questions: (1) upon whom or what is the tax imposed, (2) who is liable for the tax, and (3) who will the state pursue if the tax was not paid?

In a true gross receipt jurisdiction, the liability for tax is completely on the seller. A gross receipt tax is notably different from other taxes in that there are minimal exemptions or exclusions from the taxable measure. Generally, tangible personal property and services are equally taxable. The gross receipts' tax states are Arkansas and New Mexico. The gross receipt tax would be most easily applied to Internet purchases.

Apart from the category distinctions, the current sales and use tax system is complicated. There are almost 7,500 taxing jurisdictions with varying tax rates. Compliance with these multiple jurisdictions results in a significant expense to large and small companies. Greater efficiency in the current system might result in increased revenues to states. A comprehensive solution would likely require that state and local governments relinquish some sovereignty. It has been suggested that the state officials should attempt to "fix" the system before attempting to extend it to e-commerce.

47. Id. at 37.
48. Id.
49. Id. at 40-43.
50. Id. at 37-38.
51. Id. at 38.
52. Id.
53. Id. at 40-42.
55. Id.
Once deciding to tax e-commerce, states would then have to decide what items would be exempt from sales and use taxes and redefine tangible personal property to address purchases of software that are downloaded over the Internet. States would then have to determine how to measure the tax base of the transaction and decide how transactions would be reported. Next, states must examine how to enforce the sales and use tax systems on the new technology. The biggest hurdle, however, that states must pass is satisfying the nexus requirements of the Due Process Clause and the Commerce Clause.

IV. PART III: THE LIMITATIONS ON STATE TAXATION

To levy a sales tax at the point of sale on interstate commerce the state must satisfy the requirements of the Commerce Clause and the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution. A

The Commerce Clause is an express grant of power. "The Congress shall have Power ... [t]o regulate Commerce with foreign Nations, and among the several States ...." This enumerated power "prohibits certain state actions that interfere with interstate commerce." In its infancy, the Commerce Clause entirely prohibited states from taxing any interstate transaction.

In addition to the express grant of power, there is a judicially created extension of the Commerce Clause, the "Dormant Commerce Clause." The Supreme Court views the Dormant Commerce Clause as a limit to state regulation of commerce, even where Congress has failed to legislate upon the subject. This limit

56. One commentator has suggested the possibility of an Equal Protection claim under the Fourteenth Amendment. The Equal Protection Clause requires that states afford equal treatment to similarly situated companies. The claim would be available to an individual challenging the state action of not taxing the e-commerce vendor similarly to local vendors, resulting in disparate treatment. The vendor would basically argue that, "by serving the same market the vendors are similarly situated ... [and] if he is subject to the sales and use tax statutes then the out-of-state vendor who also participates in the market within the state should also be subject to the statutes." Groves, supra note 40, at 313.

57. U.S. CONST. art. I, § 8, cl. 3.


59. Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888) (declaring that "no state has the right to lay a tax on interstate commerce in any form").

60. Gibbons v. Ogden, 22 U.S. 1, 10 (1824).

extends to the prohibition of certain state taxes.62

Congress' authority to regulate extends to commerce with foreign nations and among the states.63 The Court has held:

This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to ... the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. "What is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation."64

In brief, the Commerce Clause prohibits state laws from interfering with interstate commerce. State regulation is forbidden if: 1) it imposes an incidental burden on interstate commerce that is disproportionate to the local benefits and 2) if it affirmatively and clearly discriminates on its face or in its effect.65

The Due Process Clause is concerned with the fundamental fairness of governmental activity. The due process requirement is that the vendor has minimum contacts with the taxing authority to the degree that a lawsuit does not offend the "traditional notions of fair play and substantial justice."66 The focus of due process is the extent to which the defendant vendor's contacts are extensive enough to require the defense of a lawsuit in that state.67 Minimum contacts are addressed to whether the vendor's actions are purposely directed toward residents of the state.68 The purposeful availment requirement prevents a defendant from being hauled into a state's court because of "'random,' 'fortuitous,' or 'attenuated' contacts."69

The leading tax case involving the taxation of remote sellers is National Bellas Hess, Inc. v. Illinois Dep't of Revenue.70 In the Bellas Hess case, a Missouri mail order house had no property, office, outlets, or any sales representatives in Illinois.71 The state of Illinois di-

62. Leloup, 127 U.S. at 649.
63. U.S. CONST. art. I, § 8, cl. 3.
68. Id. at 476.
69. Id. at 475.
70. 386 U.S. 753, 753 (1967).
71. Id. at 754.

http://open.mitchellhamline.edu/wmlr/vol27/iss3/21
rected the Missouri mail order house to collect a sales tax on products sold to Illinois residents. Bellas Hess argued the imposition violated the Due Process Clause and Commerce Clause of the U.S. Constitution. The company did not maintain any office, distribution house, sales office, warehouse, or any other place of business in Illinois. It did not have in the state an agent, salesman, canvasser, solicitor, or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or service merchandise it sold; it did not own any tangible property, real or personal, in Illinois. It had no telephone listing in Illinois and it had not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois. The Court found that the only contact that Bellas Hess had with the state was via the U.S. mail or common carrier.

The Court opined that tests for commerce and due process claims were similar. The test as to whether a state is invading Congress' authority to regulate interstate commerce is that "[s]tate taxation falling on interstate commerce...can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." And, in determining whether a state tax falls within the confines of the Due Process Clause, the Court stated that the "simple but controlling question is whether the state has given anything for which it can ask a return."

The Court looked to the practical consequences of allowing Illinois to tax Bellas Hess and the impediments to free trade. The Court noted that the variations among states in rates of tax, allowable exemptions, and administrative bookkeeping requirements could entangle Bellas Hess's interstate business "with no legitimate claim to impose a fair share of the cost of the local government." If Illinois were able to impose a tax, so could "every other state...municipality...school district, and every other political subdivision" because virtually all states and many municipalities, towns,

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72. Id. at 755.
73. Id. at 756.
74. Id. at 754.
75. Id.
76. Id.
77. Id. at 756.
78. Id. at 756 (quoting Freeman v. Hewit, 329 U.S. 249, 253 (1946)).
79. Id.
80. Id. at 759-60.
school districts, counties, and other localities levy sales and use taxes. Moreover, the Court noted that the over 2,300 localities were capable of imposing local sales taxes.

The potential administrative snafus resulting from the taxation of e-commerce are similar to those recognized in *Bellas Hess*. Currently there are approximately 7,000 taxing entities throughout the United States with varying tax rates and exemptions, and each is capable of imposing a sales or use tax. E-commerce transactions have even less contact within state boundaries than the mail order houses. The intrusion into the foreign state is minimal. Arguably, the out-of-state merchant has no contact at all within the state. Without some physical connection within the taxing state, the strongest justifications for taxing e-commerce would be to increase state revenues and to protect the local economy. Neither of these purposes appears to pass constitutional muster in the absence of congressional action.

Justice Fortas, dissenting in *Bellas Hess*, expressed a decidedly parochial and narrow view of interstate commerce. He opined that "[t]here should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient 'nexus' ... especially when coupled with the use of the credit resources of residents of Illinois, dependent as that mechanism is upon the State's banking and credit institutions." Justice Fortas believed that Bellas Hess "enjoy[ed] the benefits of, and profits from the facilities nurtured by, the State of Illinois." He did not view the collection and remittance of taxes as an uncompensated burden. Bias in favor of preserving local business is readily apparent in Justice Fortas' dissent. More glaring, however, is the failure to appreciate the administrative nightmare that could have resulted from allowing every state in which Bellas Hess did business to require it to collect and remit taxes.

*Bellas Hess* established a bright line test: a business is required

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81. *Id.* at 759 n.12.
82. *Id.* at 759.
85. *Id.* at 762.
to have some actual physical presence within the jurisdiction of the state before it can be taxed. *Bellas Hess*’s prohibition against taxing remote vendors in the absence of actual physical contact with the state can be read as supporting the non-taxation of e-commerce transactions by out-of-state jurisdictions.

The Supreme Court added a four-part test to the *Bellas Hess* standard in *Complete Auto Transit, Inc. v. Brady.* In *Complete Auto,* Mississippi levied a sales tax on automobiles manufactured outside of the state. In upholding the tax, the Court developed a four-part test to examine Commerce Clause disputes. The test consists of an inquiry into: 1) whether the tax is applied to an interstate activity with a substantial nexus with the taxing state; 2) whether the tax is fairly apportioned; 3) whether it discriminates against interstate commerce; and 4) whether it is fairly related to services provided by the state. The Supreme Court in subsequent decisions developed these queries.

The first prong of *Complete Auto* requiring the establishment of a “substantial nexus” is a difficult hurdle for states. Substantial nexus requires more than a minimal physical presence. Because mail order businesses do not meet the requirement when the only presence is by mail order or common carrier, it is doubtful that the mere presence of web page on a computer screen would be sufficient. The web page is little more than an intangible electronic presence. If an Internet merchant has no sales clerk, offices, or other non-sales activities outside of the state where the vendor is located, it is doubtful that a physical presence can be established under *Bellas Hess* or *Complete Auto.*

*Bellas Hess* remained the definitive case in this area for nearly twenty five years. During this period, however, the Supreme Court amplified its interpretation of the contacts necessary to meet the minimum contacts required to fulfill the Due Process Clause. This altered interpretation set the stage for purging of the physical presence requirement.

87. *Id.* at 275-76.
88. *Id.* at 279.
89. *Id.*
90. *E.g.,* Goldberg v. Sweet, 488 U.S. 252, 260-67 (1989) (applying and explaining each of the four prongs); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 625-26 (1981) (addressing the fourth prong and interpreting it to require only that the tax be reasonably related to the degree of the vendor’s contact within the state).
In North Dakota v. Quill Corp., the North Dakota Supreme Court reversed a trial court decision that refused to allow the state to tax a mail order company. The trial court ruled in favor of the defendant, finding that the case was indistinguishable from Bellas Hess. Specifically, it found that because the state had not shown that it spent tax revenues for the benefit of the mail order business, there was no nexus with the taxing state.

The North Dakota Supreme Court reversal was prompted in part by the conclusion that wholesale changes in both the economy and the law made it inappropriate to follow Bellas Hess. The principal change noted by the court was the remarkable growth of the mail order business from a relatively inconsequential market niche in 1967 to a Goliath with annual sales that reached the staggering figure of $183.3 billion in 1989. Moreover, the court observed that advances in computer technology greatly eased the burden of compliance with a “welter of complicated obligations” imposed by the state and local taxing authorities. The state court found that Supreme Court jurisprudence had since rendered the Bellas Hess bright line rule obsolete.

On appeal, the U.S. Supreme Court reversed the decision of the North Dakota Supreme Court, holding that the Interstate Commerce Clause of the U.S. Constitution requires an out-of-state merchant to have a physical presence before it can be obligated to collect taxes. Unlike Bellas Hess, the Quill Court found that the Due Process Clause and the Commerce Clause pose distinct limits on the taxing power of the states. The Court concluded that while a state may have had authority consistent with the Due Process Clause to tax a particular taxpayer, imposition of the tax may nonetheless have violated the Commerce Clause.

92. Id. at 205.
93. Id.
94. Id. at 208-09.
95. Id.
96. Id. at 215.
97. Id. at 209. One commentator suggests that the bright-line rule of physical presence provides too much protection to the mail order industry, especially when balanced against the states' ability to raise revenue. Shane D. Buntrock, Note, Quill Corporation v. North Dakota: Spawning the Physical Presence "Nexus" Requirement Under the Commerce Clause, 38 S.D. L. Rev. 130, 132 (1993).
98. Quill, 504 U.S. at 312.
99. Id. at 305.
100. Id.
that "notice" and "fair warning" were critical to the due process nexus analysis.\textsuperscript{101} In contrast, the Court noted that the nexus requirement to the Commerce Clause is concerned with the structural effects on the national economy.\textsuperscript{102} Because of this structural bias in favor of a national economy, the Court found that the Commerce Clause prohibits discrimination against interstate commerce.\textsuperscript{103}

\textit{Quill} rejected the conclusion that the time had come to renounce the bright line test of \textit{Bellas Hess}.\textsuperscript{104} It noted that the mail order industry's dramatic growth is probably due in part to the bright line exemption from state taxation created in \textit{Bellas Hess}.\textsuperscript{105} The \textit{Quill} Court surmised that the certainty of a bright line rule in the area of sales and use taxes fosters investment.\textsuperscript{106}

The Court concluded that Congress has the ultimate power to resolve the issue and might do so now that the Court had decided that the Due Process Clause did not prohibit the States from imposing such taxes. In the years preceding \textit{Quill}, Congress considered legislation on several occasions that would overrule \textit{Bellas Hess}.\textsuperscript{107}

\begin{itemize}
\item \textsuperscript{101} \textit{Id.} at 312.
\item \textsuperscript{102} \textit{Id.}
\item \textsuperscript{103} \textit{Id.}
\item \textsuperscript{104} \textit{Id.} at 317-18.
\item \textsuperscript{105} \textit{Id.} at 316.
\item \textsuperscript{106} \textit{Id.}
\item \textsuperscript{107} S. 545, 104th Cong. (1995); S. 1825, 103rd Cong. (1994); H.R. 2230, 101st Cong. (1989) (granting states the power to require collection of use taxes by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual sales exceeding either $12.5 million in the United States or $500,000 in the taxing state); S. 480, 101st Cong. (1989) (granting states the power to require collection of use taxes by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding either $12.5 million in the United States or $500,000 in the taxing state); S. 2968, 100th Cong. (1988) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual sales exceeding $15 million in the United States or $750,000 in the taxing state); H.R. 1891, 100th Cong. (1987) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation of business in the state and has annual gross sales exceeding $12.5 million in the United States or $500,000 in the taxing state); H.R. 1242, 100th Cong. (1987) (granting states the power to require use tax collection by out-of-state retailers and requiring retailers to file annual information returns); S. 1099, 100th Cong. (1987) (granting states the power to require use tax collection by out-of-state vendors if the vendor engages in regular or systematic solicitation in the state and had annual sales exceeding $12.5 million in the United States or $500,000 in the taxing state); S. 639, 100th Cong. (1987) (granting states the power to impose a sales or use tax on interstate sales by out-of-state retailers); S. 2913, 99th Cong. (1986) (granting states
Without the Due Process impediment, Congress was free to decide whether, when, and to what extent the States may burden mail concerns with a duty to collect use taxes.

*Quill* clarified the distinction between Due Process and the Commerce Clause with respect to establishing a nexus. Establishing a nexus under the Due Process Clause is simply a matter of notice and fair warning. “In modern day commercial life it matters little that solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers.” Now, so long as a commercial actor’s efforts are purposely directed towards residents of another state, the requirements of Due Process are satisfied. Establishing a nexus under the Commerce Clause requires a finding that the remote seller had a physical presence in the taxing state.

The Court’s holding in *Quill* is significant. Upon a close reading, it becomes evident that the *Quill* court left an opening for taxation of out-of-state merchants. By leaving the physical presence requirement intact for Commerce Clause purposes, the Court did not foreclose the possibility that *Bellas Hess* could be legislatively preempted by congressional action. It appears that the invitation for Congress to discard the physical presence requirement may have weakened the decision. Lower courts have shown a willingness to replace the *Quill* physical requirement with a less stringent standard of nexus.

In *Orvis Co. v Tax Appeals Tribunal*, New York’s highest court rejected the substantial nexus requirement. *Orvis*, a retailer and mail order business, challenged the compensating use tax upon orders placed through its mail order catalog. The court found that the level of nexus required by both the Due Process Clause and the

the power to impose a sales or use tax on interstate sales by out-of-state vendors if the vendor engages in regular or systematic solicitation and has annual taxable sales exceeding $100,000 in the United States or $25,000 within the taxing state, and requiring one uniform sales tax and use tax rate per state); H. R. 3549, 99th Cong. (1985) (granting states the power to require use tax collection by out-of-state vendor if the vendor engages in business in that state); S. 1510, 99th Cong. (1985) (granting states the power to require use tax collection by out-of-state retailers on any interstate sales); S. 983, 96th Cong. (1979); S. 282, 93rd Cong. (1973).

108. *Quill*, 504 U.S. at 308.


Commerce Clause was 'indistinguishable.' The court reasoned that the Supreme Court in *Quill* hesitantly retained the different standards of Due Process and the Commerce Clause and that the evolution of the Commerce Clause jurisprudence does not support the retention of the *Bellas Hess* requirement. This reasoning allowed the court to conclude that presence is satisfied by conduct of economic activity in the taxing state performed by the vendor's personnel or on its behalf. In other words, the slightest of presence within the state is sufficient to establish a substantial nexus.

Similarly, the Illinois Supreme Court applied the slightest presence standard in *Brown's Furniture, Inc. v. Wagner*. Brown had no property, offices or employees within the state. Brown did conduct extensive television, radio, and print advertising in Illinois and made deliveries on a regular basis. Because the periodic deliveries were not sporadic or occasional, the court found that the sales revenue gained from Illinois customers was subject to Illinois use tax.

In both *Orvis* and *Brown*, the Supreme Court denied certiorari. From this failure to grant review of the decisions, one can infer either that the Court did not want to overturn the lower court decisions because it was unhappy with *Quill* or that it was an attempt to force Congress' hand.

V. PART IV: INTERNET TAX FREEDOM ACT OF 1998

The potential devastating ramifications of taxing e-commerce prompted Congress to enact the Internet Tax Freedom Act of 1998

111. Id. at 956.
112. Id. at 959 (citing the Supreme Court's statement in *Quill*, 504 U.S. at 311 that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today.").
113. Id. at 960-61.
114. Id.
116. Id. at 798.
117. Id.
118. Id. at 804.
119. Id. at 795. See also *Standard Pressed Steel Co. v. Washington Dep't of Revenue*, 419 U.S. 560, 560 (1975). Standard's only presence in the state was one employee—an engineer who operated out of his home and consulted with a Standard customer. The Supreme Court upheld the constitutionality of Washington's business and occupational tax. Id. at 575.
The measure was enacted based on a finding that: inconsistent and inadministrable taxes imposed on the Internet, Internet Access, and on-line services by Federal, State, and local governments would subject consumers, businesses, and other users engaged in interstate and foreign commerce to multiple, confusing, and burdensome taxation, and restrict the growth and continued technological maturation of the Internet itself \(^{121}\). The twenty-first century marketplace requires a twenty-first century sales tax system that is more uniform, consistent and streamlined. \(^{122}\)

ITFA calls for a moratorium on any new Internet taxes—a three year freeze until 2001—and establishes an Advisory Commission on Electronic Commerce to report its findings and legislative suggestions to Congress by April 2000. \(^{123}\) The commission is comprised of members representing the varying interests within the telecommunications industry and federal, state, and local governments. The following are current members of the Commission:

- Mr. Joseph Guttenberg, Senior Advisor, Office of Tax Policy, U.S. Treasury Department
- Mr. Robert Novick, General Counsel, U.S. Department of Commerce
- Mr. Gene LeBrun, President (1997-1999), National Conference of Commissioners on Uniform State Laws
- Mr. Theodore Waitt, Chairman, Gateway, Inc.
- Mr. Michael Armstrong, Chairman of the Board, AT&T
- Mr. Robert Pittman, President & Chief Operating Officer, America Online
- The Honorable Ron Kirk, Mayor, City of Dallas
- The Honorable Gary Locke, Governor, State of Washington
- The Honorable Michael Leavitt, Governor, State of Utah
- The Honorable Delna Jones, County Commis-

The three year moratorium on special taxation of the Internet bars state or local governments from taxing Internet access—the $19.95 or so that many Americans pay monthly to America Online, Compu-Serve, Erol’s or other similar services to access the Internet. There is also a three year moratorium on multiple and discriminatory taxes on electronic commerce. This section of ITFA bars state and local governments from imposing taxes that would subject buyers and sellers of electronic commerce to taxation in multiple states.

ITFA protects against the imposition of new tax liability for consumers and vendors involved in commercial transactions over the Internet, including the application of discriminatory tax collection imposed on out-of-state business through strained interpretations of “nexus.” It also protects from taxation, for the duration

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124. Advisory Commission on Electronic Commerce (Nov 15, 1999), at http://www.ecommercecommission.org (last visited Nov. 15, 1999). The Commission did not receive funding from Congress. Instead, Congress gave the Commission “gift authority.” Initial funding was provided by the Commonwealth of Virginia and six corporate members. The Commission then asked Congress for additional funding. On November 29, 1999, President Clinton signed an appropriations bill that included $1.4 million in fiscal year 2000 operating funds for the Commission. Id.

125. Id.
of the moratorium, goods and services over the Internet with no comparable offline equivalent. The Advisory Commission will study the electronic commerce tax issues and report back to Congress after eighteen months on whether electronic commerce should be taxed and if so how it can be taxed in a manner that ensures such commerce will not be subject to special multiple or discretionary taxes. Congress, of course, retains full authority to change or discard the commission's proposals.

The eleven states that currently levy a tax on Internet (before October 1, 1998) can still do so under "a grandfather's clause" of the IFTA. A limited grandfather clause permits the handful of states already taking steps to tax Internet access (Connecticut, Iowa, New Mexico, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin) to continue to do so if they can demonstrate that their taxes had already been generally imposed and actually enforced on Internet access providers prior to October 1, 1998.

The fundamental task facing the Advisory Commission is arriving at recommendations that ensure economics instead of taxes shape the future of Internet commerce. The consensus is that the present sales tax system is in disarray. It is a burden for small merchants and large corporations alike. To comply with the current regulations of the various jurisdictions is an onerous task for large corporations such as AT&T, which must process between fifty

126. Id.
127. Id.
128. Id.
129. Michael J. McIntyre, Commentary: Taxing Electronic Commerce Fairly and Efficiently, 52 TAX L. REV. 625, 628 (1997). One commentator views the task of the commission is to develop a practical strategy for saving retail sales tax from the "corrosive effects and cross-border shopping, through catalogs and over the Internet." Id.
130. David C. Blum, State and Local Taxing Authorities: Taking More Than Their Fair Share of the Electronic Information Age, 14 J. MARSHALL J. COMPUTER & INFO. L. 493, 496 (1996). The author argues that the states should not be allowed to tax users and providers of e-commerce absent "clear and specific statutory authority." Id. The author notes that "each jurisdiction taxes differently." Id. The definitions, exemptions, tax rates, classifications, and threshold at taxability are generally unique to each jurisdiction. Id. at 495; see also McIntyre, supra note 129, at 630. McIntyre offers an extensive discussion of what is wrong with the sales tax. He points out (among other things) that sales taxes do not really amount to a tax on personal consumption because such items as housing, large categories of personal services, and intangibles are excluded. McIntyre, supra note 129, at 650.
131. In the United States alone, more than 6,500 state and local jurisdictions impose sales and use taxes. Morse, supra note 15, at 1139.
to sixty thousand forms per year. Taxation of e-commerce under the present system would burden the administrative process and complicate it as well. Proponents of taxation proffer that innovative software developments would ameliorate the burdens. However, the Commission and eventually Congress must consider whether taxation of e-commerce is a technical problem of how to efficiently administer the system or a policy question of whether the tax should exist at all.

VI. PART V: ANALYSIS

The taxation of e-commerce has sparked a vigorous debate. Commentators have advanced diverse arguments and proposals. This section will first examine a sampling of these paradigms and arguments and then make recommendations. The suggestions range from a uniform federal tax, to granting states carte blanche taxation powers, to no taxation of e-commerce. Comments reflecting numerous mutations of these suggestions have also been submitted to the Advisory Commission on Electronic Commerce.¹³² They too will be summarily discussed.

Generally, the proponents of state taxation assert that on-line sales are too significant to be exempt. The plea is that the states have already lost tons of revenue to the mail order business because the mail order lobby is viewed as too powerful and too entrenched to expect Congressional action.¹³³ Therefore, they urge Congress to move while the Internet vendors are unorganized and lack influence.¹³⁴ The fear is that state and local government finances will


¹³³. At least thirteen unsuccessful bills have been introduced in Congress. Most of the bills never got past the subcommittee hearings.

¹³⁴. In contrast to the unorganized Internet vendors, the mail-order industry has the support of several national organizations. Among them are the Direct Marketing Association (DMA), which represents 3,600 members, the National Mail Order Association, and the American Mail Order Association. TARA E. SHEETS, ENCYCLOPEDIA OF ASSOCIATIONS § 1 at 243, 260-62 (35th ed. 1999).
suffer because of the revenue loss. Many states have started to include taxable services within their definition of gross receipts to increase sales tax revenues. In particular, the fear is that state finances are being undone by rapid changes in global commerce and information technologies. Others cite the disadvantage to the local main street retailer who is unable to compete with the lower Internet prices. And of course, there is the equitable argument (though not widely explored), that the failure to tax Internet purchases will unfairly burden the poor who have no access to computers and in turn Internet shopping. Statistics reveal that most Internet shoppers are affluent. To be sure, these are all legitimate concerns. Whether they should implicate economic or tax policy is not as clear.

Critics of state taxation of Internet transactions assert that the additional revenues are unnecessary and that taxation will stifle growth of the electronic industry. They argue that the growth of electronic commerce will benefit the economy and trickle down to the states in the form of increased revenues. The premise is that allowing states to tax Internet commerce will force relocation and weaken the U.S.’s competitive position. There is considerable opposition in Congress against taxation of on-line services.

One commentator argues that Congress should remove the Commerce Clause impediments, and thereby clear the path for a

DMA studies consumer attitudes and provides review of pending federal and state regulations that affect the mail-order industry. Id. at 260. The other two organizations list “providing expertise to legislators” as one of their activities. Id. at 243, 262.

135. For a discussion of how the political climate with respect to balanced budgets regulations and decreased federal funding to the state may affect state fiscal health, see R. Scott Grierson, State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services, 16 LOY. L.A. ENT. L. REV. 603, 604 (1996). Many states have started to include taxable services within their definitions of gross receipts to increase sales tax revenues. Id.

136. HERBERT I. SCHILLER, INFORMATION INEQUALITY: THE DEEPENING SOCIAL CRISIS IN AMERICA (1996) (arguing that developing technologies are exacerbating inequity in the social order; identifying privatization, deregulation, and commercialization as the primary culprits); see also Governor James S. Gilmore, No Internet Tax: A Proposal Submitted to the “Policies & Options” Paper of the Advisory Commission on Electronic Commerce, at http://www.ecommercecommission.org/document/107gilmoreProposal.doc (proposing that the Federal Welfare Guidelines be amended to permit states to spend TANF (Temporary Assistance to Needy Families) surpluses to buy computers and Internet access for needy families).

137. Dean F. Andal, Read My E-mail: No New Taxes, 12 ST. TAX NOTES 1387, 1388 (1997).

138. Id.
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federal uniform tax. The author notes that while Congress cannot alter the Due Process analysis, the tax scheme could be designed to avoid implication. However, the concern with Due Process is perhaps misdirected. Under Bellas Hess the inquiry to determine whether a state tax scheme passed the Due Process hurdle was whether the state has given anything of which it can ask something in return. In applying this standard, the Court imposed a physical presence requirement. Quill, however, in overruling Bellas Hess held that establishing the nexus necessary to assert tax jurisdiction is simply a matter of notice and fair warning. The merchant's efforts only need to be purposely directed towards the residents of another state. Nevertheless, the commentator offers three possible models.

The first suggestion is that the purchaser pays the sales tax of the vendor's jurisdiction. This model is referred to as the "source tax." For example, under this model, a New Jersey consumer who makes Internet purchases from an Ohio merchant must pay an Ohio sales tax. At first glance, this approach seems uncomplicated and reasonable. Its simplicity, however, disguises the economic consequences. This model is almost certain to prompt a shift in the economy. Consumers will favor jurisdictions with the lowest tax rate, and businesses are likely to relocate to states with lower tax rates.

The second model requires the vendor to collect and remit the use tax to the purchaser's jurisdiction. This model is referred to as the "destination model." The consumer is taxed according to the state of residence. This model would probably not cause an economic shift. It also offers no particular advantage to the consumer and does not place the main street merchant at a disadvantage. However, the model would create an administrative night-

140. Id. at 1221.
143. Quill, 504 U.S. at 308.
144. Murphy, supra note 139, at 1197.
145. Id.
146. Id.
147. Id.
mare because the vendor would have to determine the tax rate of every possible jurisdiction out of a universe of over 30,000 taxing jurisdictions.\footnote{Evanthesia Schisted, Net Taxes: States Try Cashing in on Online Commerce, CA. LAW (1997).}

Software is available to perform these functions. However, the software is expensive and potentially inaccurate. It is estimated that a vendor would have to earn $50,000 per year to afford the expense of the software and updating. It has been suggested that legislation would exempt small vendors.\footnote{Id. at 216 n.61.} This, however, would defeat the purpose of taxation, assuming the aim is to ameliorate the shifting economy.

In addition to its expense, the software uses information obtained from ZIP codes to determine the applicable tax.\footnote{Morse, supra note 15, at 1123.} This information is potentially inaccurate. It would be difficult to track consumers who order via a laptop taken out of state or who use an e-mail address assigned to locations different from the home address. It would also be difficult to track someone making purchases from a summer home that also qualifies as a residence. In each instance, it would be difficult to track the transaction and relatively easy to avoid the tax.\footnote{Charles E. McLure, Jr., Taxation of Electronic Commerce: Economic Objectives, Technology, Constraints and Tax Laws, 52 TAX L. REV. 269, 317 (1997).} Moreover, compliance involves not just tracking, but returns must be filed and funds disbursed.\footnote{Id.} Commentators who suggest that software is the panacea either fail to understand the process or underestimate the actual burdens imposed.

The final model suggests federal legislation\footnote{Presently the Telecommunications Act of 1996 contains two provisions that could apply to the taxation of Internet transactions. The act prohibits states and localities from inhibiting telecommunications services and prohibits local taxation of direct-to-home satellite communications services. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (codified as amended in scattered sections of 47 U.S.C.).} that would result in a uniform tax rate.\footnote{Murphy, supra note 139, at 1203.} A tax would be imposed on all tangible goods sold over the Internet.\footnote{Id.} The recommendation is that the federal tax rate represents an average of the rates currently applied by the state or approximately five percent.\footnote{Id.} The federal uniform
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The tax is flawed on several accounts. It would not prevent the shifting of the economy. Compliance would be difficult and perhaps so expensive to administer that much of the revenues would be consumed by the cost of administration. Moreover, any federal taxation scheme should be more in keeping with international design of no tariffs and taxes.

There is tremendous support for federal legislation that would base jurisdiction upon economic presence. Economic presence would be established once the outside vendor reached a certain volume of sales within the state. Charles McLure, author of The Internet Encyclopedia, believes that Quill should be replaced with a rule allowing states to impose a collection duty on remote sellers whenever the volume of their sales exceeds a minimum amount.\(^{157}\)

Another school of thought is that Congress should exercise authority to eliminate the outdated physical presence requirement and allow states to tax.\(^ {158}\) Proponents of this model insist that an actual physical presence requirement is not necessary. They reason that a nexus is established because the remote vendor enjoys: (1) a police protected infrastructure to assist in the transfer of goods, (2) sound banking institutions to support credit transactions, (3) consumer protection laws, and (4) waste disposal of mail and packaging materials.\(^ {159}\) Others advance the idea that the purely informational presence of a website would cease once the first sale is made in the state.

Each of the aforementioned proposals has merit. In the final analysis, however, the practical economic consequences of the taxation of e-commerce must be the deciding factor. The Internet is fueling the current economic boom in the United States in large part. A study conducted by the University of Texas Center for Research in Electronic Commerce reports that the nation’s Internet based economy produced over $507 billion in revenues and created 2.3 million jobs.\(^ {160}\) According to the study, “Internet and information technology now account for more than half of the capital investment in our country.”\(^ {161}\)

Increased tax collections are a direct by-product of the Inter-

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157. McLure, Jr., supra note 151, at 395-400.
159. Id.
161. Id.
net induced growth and increased productivity. Those that argue that tax-free Internet sales will bankrupt state budgets are apparently oblivious of evidence to the contrary. Instead of a huge revenue loss, a report by the National Governor's Association indicates that collectively the states had an $11 billion dollar tax surplus in 1998. The surplus existed notwithstanding tax cuts in 1998 of $5.3 billion and $4.9 billion in 1997.

Furthermore, a tax on e-commerce would likely depress sales. Several studies have shown that sales would decrease significantly if a tax were imposed. It appears that sales would not only decrease because of the higher prices resulting from taxation but, in part, to privacy concerns. The nature of Internet taxation would require that all sales transactions be reported to government collection agents who could view the purchases of consumers. BizRate.com found that 75% of customers said they would buy less if Internet sales were taxed and a Favrizio-Mclaughlin & Associates survey found that 34% of purchasers would be less inclined to buy if records were kept of the purchases. Reduced sales may also lead to a significant reduction in the value of Internet-based retail stock.

As for the technological and administrative ramifications of taxing e-commerce, there are convincing pro and con arguments. Some argue that innovative software would facilitate implementation. Others argue that the software is complicated and cost prohibitive for most entrepreneurs. The issue, however, is not the ease or difficulty in administration. Rather, the concern must be sound economic policy.

Proponents of e-commerce taxation offer several reasonable economic arguments. One argument is that taxation would have a negative impact on the Internet "bubble economy," but not the overall economy, because while stock prices might go down, real productive capacity of the economy will not. The stronger argument, however, is that non-taxation of Internet commerce results in

162. Id. at 2; see generally eCommerce Coalition, supra note 54.
164. Id. at 3 (noting that University of Chicago Professor Austan Goolsbee presented evidence to the commission that the volume of sales over the Internet would decline 30% if a sales tax were imposed).
165. Id.
166. Id.
168. eCommerce Coalition, supra note 54.
a subsidy for Internet commerce. To be sure, the viewing of tax-free treatment as a preference or subsidy is reasonable. However, as a matter of sound policy we should endorse tax-free treatment in order to realize the Internet’s tremendous social and economic impact. Tax preferences and subsidies of certain businesses are routinely granted where there is a potential for greater public good.\textsuperscript{169} As for the revenue argument, the national interest of fostering e-commerce growth outweighs an individual state’s interest in preserving or increasing its tax base.

**VII. CONCLUSION**

There must be no taxation of e-commerce except within the parameters of the existing nexus requirement. Congress should clarify the existing nexus standards to prevent further erosion by the lower courts. As a possible solution, Congress could specify the activities that would not create a tax nexus.\textsuperscript{170} For example, the activities could include “solicitation of orders or contracts; shipment of goods; presence of intangible properties; the use of the Internet, ISPs, or servers; the affiliation with another entity; or the use of an unaffiliated representative or independent contractor.”\textsuperscript{171}

This paper has dealt with the narrow area of taxation of tangible goods. However, it is the author’s opinion that the prohibition should extend to digital products and all other intangible goods sold over the Internet. If tangible goods were taxed it would be only a matter of time before intangible goods, services, and information would be taxed as well.\textsuperscript{172} The time has come when rendering unto Caesar, be it on the international,\textsuperscript{173} national, state, or lo-
that change the nature or location of transactions; and 3) not conflict with the United States' tax system. A Framework for Global Electronic Commerce, 127 DAILY TAX REP. (BNA), July 2, 1997, at 1-13 (quoting former Vice President Al Gore); Electronic Commerce: Clinton Unveils Report Advocating National, Global Harmony on Internet Taxes, 127 DAILY TAX REP. (BNA), July 2, 1997 at § GG.