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NOT TOO LATE TO STOP THE INTERNET TAX CRUSADE

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Should state and local governments have the right to tax the Internet, a global communications medium? This topic has been the subject of hot debate in Congress. In early 1997, Representative Christopher Cox (R–CA) and Senator Ron Wyden (D–OR) introduced the Internet Tax Freedom Act (H.R. 1054/S. 442), under which there would be a six-year moratorium on state or local Internet taxes in order to facilitate further study of the feasibility of taxing commerce over the Internet. Both bills were approved in committee last fall and have continued to attract bipartisan support. Policies like those embodied in the Internet Tax Freedom Act would keep this vibrant global medium free of unnecessary taxes that could strangle its technological evolution. An intensive lobbying effort by state and local interest groups, however, recently forced Representative Cox and others in Congress to consider a compromise that could open the floodgates of state and local taxation. Congress would be wise to reject the compromise and push forward with its original plan to keep the heavy hand of government off Internet commerce.

PROBLEMS WITH THE PRO-TAX COMPROMISE

The proposed Internet Tax Freedom Act has drawn vociferous opposition from state and local policy makers who oppose any limits on their efforts to reap revenue from this technology for state treasuries. During the first three months of 1998, an intensive lobbying effort was waged by such state and local groups as the National Governors' Association, National Conference of State Legislators, Council of State Governments, National Association of Counties, National League of Cities, and U.S. Conference of Mayors. Their purpose: To convince the media, the public, and congressional leaders that the Internet Tax Freedom Act is an unjustifiable federal preemption of state and local taxing authority.

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Although state and local governments enjoy a significant amount of freedom in determining their tax policies, their taxing discretion does not extend beyond their geographic boundaries. Policymakers and businesses opposed to Internet taxes argue that the Internet should remain a "global free trade zone," unencumbered by overlapping and discriminatory taxes imposed by the country's more than 30,000 taxing jurisdictions. Multiple layers of taxation inevitably would hinder the continued growth of this technology.

The U.S. Constitution is clear: Congress has sole jurisdiction over matters relating to interstate commerce. Both the Internet and Internet-based transactions fall squarely within the ambit of interstate

commerce. It is difficult to think of another industry or technology in modern history with a more interstate (indeed, global) scope than the Internet. It is difficult to imagine how fast-paced, intangible electronic transactions could be taxed efficiently by 30,000 jurisdictions, to say nothing of the reasons that some federal legislators would cave in to the untenable and unconstitutional demands put forth by state and local officials.

On March 19, 1998, Representative Cox announced a compromise with state and local officials that would (1) decrease the length of the moratorium from six to three years; (2) grandfather in existing state and local Internet taxes; and (3) establish an open-ended Commission on Internet Commerce, which would be required to submit to the President a system for state-based Internet taxation within two years of enactment. The President then would submit a report to Congress that recommends either approving or disapproving the commission's proposals.

The establishment of such a commission presents several problems:

First, representatives from the state and local groups that lobbied for the right to impose new taxes on the Internet (including the interest groups listed above) would constitute a majority of the 29-member commission. With such majority representation, any decisions that were made regarding future tax policy most likely would be geared toward the general expansion of Internet taxes.

Second, although the compromise sensibly would require the Commission on Internet Commerce to ban specific types of Internet taxes (such as access taxes, bit taxes, or bandwidth taxes), it would nullify this policy's effect partially by encouraging the commission to establish the equivalent of a national sales tax on Internet transactions. The commission would construct guidelines allowing states to impose Internet sales or use taxes so long as they do so in a uniform, simplified manner. Not only is it unlikely that these taxes would be imposed in a uniform, simplified manner, the reason remains unclear for the states to be given the power to collect taxes extraterritorially.

Third, the Commission on Internet Commerce would be encouraged to use an independent, third-party system for the administration and collection of sales and use taxes. Although this may sound reasonable, in practice the third-party agency could evolve into a large agency with an incentive to collect more and more taxes to generate higher profits. History is replete with examples of such third-party tax collection systems that violated taxpayers' rights and privacy. Such a system imposed on the Internet would destroy much of the Internet's vitality and ingenuity and discourage the continued growth of electronic commerce.

Fourth, an appointed commission would not be accountable to the electorate. Congress should not delegate any of its responsibilities or authority to such a group; it should make such decisions on its own, using explicit statutory language. Although no proposals would take effect until Congress and the President had signed them into law, those who backed creating such a commission must be ready for unintended consequences. For example, once it proposed an Internet tax system, the commission would lobby Congress to support it. Congress would be hard-pressed to withstand the political pressure from the powerful state and local interest groups represented on the commission.

NO TIME TO BACK DOWN

In reality, the so-called compromise bill represents a substantial sellout to state and local officials who are seeking tax revenue for their own treasuries. Once the shortened moratorium had expired, the Commission on Internet Commerce would pressure federal policy makers to implement the wishes of these special interests, making the Internet the latest victim of what Representative Cox once called America's "tax vultures."

It still is possible for Congress to avoid adopting this shortsighted compromise, which received only a tepid response in the Senate. Senator Wyden and the chairman of the Senate Commerce Committee, John McCain (R–AZ), have expressed their dissatisfaction with elements of the deal. Other Members should hold fast to the original plan to keep the Internet free of burdensome and discriminatory taxes. Congress should send a clear message to the state and local governments that want to tax—unconstitutionally—this exciting new global medium: No new Internet taxes.

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