

# Through the Looking Glass



**A CAGW Special Report**

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*How Taxation Threatens to Shut Down Commerce on the Internet*

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February 15, 2000



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## Introduction

If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.  
-- Ronald Reagan on government

There's nothing like success to provoke the government. Very few things have been as successful as the Internet. Envious of innovation, achievement and prosperity, politicians and bureaucrats can be relied upon to unleash a fusillade of taxation and regulations to punish such audacity. Government officials often mask their lust for taxpayers' money under a veneer of "fairness" and "justice." This government onslaught usually leads to higher prices, less innovation, and fewer jobs. As the Internet becomes the most attractive new target for zealous regulators and tax-hungry politicians, taxpayers should hold onto their wallets.

## Background

The Internet is not a single entity, but a worldwide, interconnected web of communications networks, computers and databases. The Internet is everything the government is not: decentralized, efficient, fast moving, privately managed and extremely popular. No single organization owns, manages or controls the Internet, another point of contention for a government seeking control. The most noteworthy aspect of the Internet is the World Wide Web, also known simply as the "Web." In 1992, the Web was known to a relatively few individuals outside academia. At that time, it was a text-based medium used primarily by engineers, scientists and computer enthusiasts. The first commercial browser was introduced in 1993, allowing text and graphics to be viewed over the Web. In 1995, its current infrastructure was put into place. Since then, the Web has experienced unprecedented growth. Today, anyone anywhere in the world has access to information, products and virtually anything else regardless of the individual's physical location. Nothing short of revolutionary, this new commerce and communication is faster, less expensive and more efficient than ever.

People around the world are using the Internet in exponentially increasing numbers. Traffic on the Internet is estimated to double every 100 days,<sup>1</sup> and access to the Internet has grown at a phenomenal rate. When compared to technologies of the past, the speed of its growth dwarfs that of any previous technological advance: the telephone took 38 years to penetrate 30 percent of U.S. households, television took 17 years to reach that level of availability, and personal computers took 13 years. Once the Web made access to the Internet available to all households, it took less than seven years to reach the 30 percent penetration level.<sup>2</sup> Forrester Research found that Internet access in 1994 stood at 5.8 million households and projects that access should reach 60 million households by the year 2003. These numbers reflect a growth in the percentage of all U.S. households that have access to the Internet from about 5 percent in 1994 to 50 percent by 2003.<sup>3</sup>

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<sup>1</sup> UUNet as noted in *Framework for Global Electronic Commerce, Chapter Two: Building Out the Internet*, U.S. Department of Commerce, Secretariat for Electronic Commerce, April 16, 1998. Available at <http://www.ecommerce.gov/chapter2.htm>.

<sup>2</sup> *State of the Internet: USIC's Report on Use & Threats in 1999*, United States Internet Council, April 1999 ["USIC Report"]. Available at [http://www.usic.org/currentsite/usic\\_state\\_of\\_net99.htm](http://www.usic.org/currentsite/usic_state_of_net99.htm).

<sup>3</sup> *Idem.*

In 1969, there were four Internet hosts in the entire world. By 1995, there were 6.6 million. By January 1999, the number of hosts had exploded to 43.2 million.<sup>4</sup> Only 200 domain names per month were being registered in 1995. By July 1997, the volume of domain name registration had reached more than 125,000 names per month.<sup>5</sup> Between 1998 and 1999, 2,000 new secure Web sites were being added each month, which indicates the number of businesses flocking to the Internet or expanding their online presence.<sup>6</sup> International Data Corporation put the number of web pages on the Web at 829 million in 1998 and projects that the number will skyrocket to 7.7 billion by 2002.<sup>7</sup>

The Nasdaq Stock Market, the nation's foremost barometer of high-tech growth, put the market value of the more than 4,800 companies listed on Nasdaq at \$5.2 trillion at the end of 1999, up more than 100 percent from year-end 1998.<sup>8</sup> The Nasdaq composite index reached a record 4,069.31 at the end of 1999, an increase of 85.59 percent in one year.<sup>9</sup> The information technology sector has driven more than a quarter of all economic growth in recent years.<sup>10</sup> What makes this dramatic increase in this sector's share of the economy even more remarkable is the fact that information technology prices, adjusted for quality improvements, have been falling while prices in the rest of the economy have been rising. In 1996 and 1997, declining prices in the information technology sector actually reined in overall prices by an estimated one full percentage point.<sup>11</sup> The U.S. Internet economy revenues grew at an estimated compounded average growth rate (CAGR) of 174.5 percent from 1995 to 1998, compared with the overall U.S. CAGR of 2.8 percent.<sup>12</sup> According to Megan Graham-Hackett, director of technology research for Standard & Poor's Equity Group, this is just the "beginning of something big."<sup>13</sup>

The number of Internet-related jobs increased from 1.6 million in 1998 to 2.3 million in 1999, a 44 percent increase, as new companies were created and others shifted employees to new assignments to take advantage of opportunities created by the Internet economy. Revenues have increased faster than staffing figures, suggesting productivity gains derived from the Internet. High-tech workers earn 73 percent more than workers in other sectors of the economy,<sup>14</sup> and the job demand for these workers will be 9.5 million by 2006.<sup>15</sup>

None of this has gone unnoticed by the insatiable government behemoth. The speed of the Internet allowed it to outpace ossified legislatures and bureaucrats before they could react. However, when spenders in government did begin to lurch toward this new prey, Congress passed the Internet Tax Freedom Act in 1998, which placed a three-year moratorium on new

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<sup>4</sup> Network Wizards <<http://www.nw.com/zone/host-count-history>>.

<sup>5</sup> Testimony of Gabriel Battista, CEO of Network Solutions, Inc., before the House Committee on Science, Subcommittee on Basic Research, Sept. 25, 1997. Available at <[http://www.house.gov/science/battista\\_9-25.html](http://www.house.gov/science/battista_9-25.html)>.

<sup>6</sup> *Measuring the Internet Economy*, Anitesh Barua and Andrew B. Whinston, Center for Research in Electronic Commerce, Graduate School of Business, University of Texas at Austin, Oct. 1999, p. 4. Available at <[http://www.InternetIndicators.com/Full\\_Report.PDF](http://www.InternetIndicators.com/Full_Report.PDF)>.

<sup>7</sup> *USIC Report*.

<sup>8</sup> *Nasdaq Concludes Record-breaking Year as Demonstrated in Preliminary Year-End Results: Nasdaq Indices Soar, Composite Index Shatters 3000 and 4000 Share Volume Reaches All-Time Record*, The Nasdaq Stock Market, Inc., Dec. 31, 1999. Available at <[http://www.nasdaq.com/reference/sn\\_nasdaq\\_record\\_breaking\\_year.stm](http://www.nasdaq.com/reference/sn_nasdaq_record_breaking_year.stm)>.

<sup>9</sup> *Idem*.

<sup>10</sup> *The Emerging Digital Economy*, United States Department of Commerce, April 1998, p. 6 ["Emerging Digital Economy"]. Available at <<http://www.ecommerce.gov/ederept.pdf>>.

<sup>11</sup> *Ibid.*, p. 5.

<sup>12</sup> *Measuring the Internet Economy: An Exploratory Study*, Anitesh Barua, Jon Pinnell, Jay Shutter, and Andrew B. Whinston, Center for Research in Electronic Commerce Graduate School of Business, University of Texas at Austin, June 10, 1999, p. 8. Available at <[http://cism.bus.utexas.edu/works/articles/internet\\_economy.pdf](http://cism.bus.utexas.edu/works/articles/internet_economy.pdf)>.

<sup>13</sup> *Washington Post*, "Nasdaq Hits 4000 for 84% Gain in '99," Dec. 30, 1999, p. 1, col. 1.

<sup>14</sup> *Cybernation*, American Electronics Association, 1998. Available at <<http://www.aeanet.org/aeanet>>.

<sup>15</sup> Bureau of Labor Statistics as cited in *The Emerging Digital Economy*, p. 49.

Internet taxes. The legislation also created the Advisory Commission on Electronic Commerce, also known as the e-Commerce Commission. The commission was authorized to study the effects of taxes and tariff treatment of Internet transactions and access, and to make recommendations to Congress reflecting the study's results. Any recommendations are required to be "tax and technologically neutral." In practice, however, some members of the commission have largely ignored the debate over whether or not to tax the Internet, instead focusing most of their energy on *how* to tax it.

## The Move Against the Net

In November 1999, a major proposal to tax the Internet was submitted to the commission by the National Governors Association (NGA), the National Conference of State Legislatures, the Council of State Governments, the National Association of Counties, the United States Conference of Mayors, and the International City/County Management Association, all veterans of increasing government and taxes.<sup>16</sup> The plan, entitled *Streamlined Sales Tax System for the 21<sup>st</sup> Century*, envisions a "completely unified" sales tax throughout the United States that would apply to the Internet, mail-order transactions and traditional retail sales. It calls for the creation of a new tax collection regime, referred to as "trusted third parties" (TTPs). These TTPs would be tax clearinghouses, collecting and remitting sales taxes based on the purchaser's tax jurisdiction. When an online order is placed, the seller would notify the TTP and the purchaser's credit card company to determine the individual's tax jurisdiction. The TTP would then notify the seller of the appropriate tax amount, and the credit card company would collect the funds and then remit the tax to the clearinghouse. The clearinghouse would then distribute the funds to the states and localities and would be paid by a percentage of what it collects. The TTPs would be licensed by the state, and all costs associated with the system would be the responsibility of state and local governments.<sup>17</sup>

## Scare Tactics Are Employed to Increase Taxes

The purported motivation behind the plan to tax e-commerce, according to its authors, is to establish a "level playing field" for "America's Mom and Pop stores" and to stem the alleged revenue drains being experienced by state and local governments. Safeguarding these revenue streams would "ensure that states will be able to continue providing vital services to the citizens of their states."<sup>18</sup> Plan proponents invoke images of shuttered storefronts in towns nationwide, deprived of fire or police protection. This hyperbole betrays their desperation to confiscate more money.

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<sup>16</sup> Financed through taxpayer money, these organizations lobby the federal government for federal grants, which drives tax increases, and "promot[e] a social and economic agenda that transfers decisionmaking authority from citizens to bureaucrats and policy experts," *Organization Trends*, Feb. 1998, Capital Research Center, Washington, D.C. Available at <<http://www.capitalresearch.org/trends/ot-0298.htm>>.

<sup>17</sup> *Streamlined Sales Tax System for the 21st Century*, National Governors Association, Washington, D.C. ["Streamlined Sales Tax System"]. Available at <<http://www.nga.org/Internet/Proposal.asp>>.

<sup>18</sup> *E-Quality: Ensuring a Level Playing Field for American Business*, National Governors Association, Washington, D.C. ["E-Quality"]. Available at <<http://www.nga.org/Internet/equality.asp>>.

The veracity of these claims is highly suspect. Though the NGA claims to “oppose Internet taxes, new taxes on the Internet,”<sup>19</sup> it then proceeds to chew up several megabytes of hard drive outlining how it wants to do just that in the worst way.

The NGA also cites “tax discrimination” against traditional retailers as a driving concern. If the elimination of tax discrimination were the true motive of the Internet tax proponents, they would flatten the current tax code in their jurisdictions, and eliminate exemptions and deductions.

## Plan Would Increase Tax Complexity And Burden

The NGA’s plan is more than a threat to the vitality of the Internet; it is an attack on consumers, businesses and the economy. Its stated goal of creating a national sales tax *in addition* to the current income and other taxes is reason enough to reject it out of hand. The NGA freely admits that there are currently 7,000 tax rates and 500 tax bases across the country.<sup>20</sup> Others cite the number of tax jurisdictions at 30,000<sup>21</sup> and the number of sales and use taxes at 40,000.<sup>22</sup> The creation and management of this system, or any plan to tax the Internet, would be nightmarishly complex. The NGA is proposing to put a bureaucrat on every cybercorner, an improbable and expensive task.

Paradoxically, the plan actually cites the very complexity of the nation’s patchwork of taxes as a reason to “simplify” our current sales tax system and create one “uniform” sales tax throughout the country.<sup>23</sup> The audacity of this claim is striking. First, states already have the power to “simplify” the tax systems within their own borders. Second, it is not desirable to have a single tax system because different systems tend to place a downward pressure on tax burdens when movement between tax jurisdictions is possible. The growth of Internet commerce is a textbook example of rational economic behavior: people living in jurisdictions with high sales taxes are significantly more likely to buy online.<sup>24</sup>

The NGA proposes to impose a “simple tax.” What the NGA really means is that it perceives this as a simple tax to raise. This is political Nirvana. Politicians from one state would have the power to tax the people of a different state -- people who couldn’t vote them out of office.

In a classic example of political doublespeak, the NGA claims that participation in this plan would be voluntary, but then goes on to state that “financial incentives and penalties would be adopted to ensure that all states participate in the uniform system.”<sup>25</sup> The specifics are omitted, but it can be safely assumed that the term “financial incentives” means that a fraction of the

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<sup>19</sup> *Idem.*

<sup>20</sup> *Streamlined Sales Tax System.*

<sup>21</sup> *Taxing the Internet*, William F. Shughart II, The Independent Institute, Oakland, Calif., Dec. 14, 1999. Available at <<http://independent.org/tii/news/991214Shughart.html>>.

<sup>22</sup> Michael P. Boyle, Chief Tax Counsel and General Auditor, Microsoft Corporation as presented at the Internet Law & Policy Forum, Jan. 8, 1998. Available at <<http://ilpf.org/archive/confer98/present/boyle/sld003.htm>>.

<sup>23</sup> *Building a Sales Tax System for the 21st Century*, National Governors Association. Available at <<http://www.nga.org/Internet/Plan.asp>>.

<sup>24</sup> *In a World Without Borders: The Impact of Taxes on Internet Commerce*, Austan Goolsbee, University of Chicago and National Bureau of Economic Research, July 1999 [“In a World Without Borders”], p. 10. Available at <<http://gsbwww.uchicago.edu/fac/austan.goolsbee/research/intertax.pdf>>.

<sup>25</sup> *Streamlined Sales Tax System.*

money taken from the participating states would be returned. The term “penalties” most likely translates into a larger amount of money taken from non participating states, a typical enforcement method used by federal government when it seeks to impose its will on the states. However, the plan is silent as to under what authority and mechanism these penalties would be imposed. This should set off alarm bells to residents of states that currently have no sales tax and those that already may be justifiably reluctant to participate in the NGA’s scheme.

## Consumers and Commerce in Plan’s Crosshairs

The NGA proposal cites excessive burdens placed on traditional retailers in addition to tax discrimination against those retailers as a justification for imposing taxes on the Internet.<sup>26</sup> The NGA uses the term “discrimination” to refer to the economic burdens ostensibly borne by traditional “mom and pop” stores relative to their Internet counterparts. However, the solution is not to impose another tax, but rather to relieve the crushing burdens (e.g. high taxes, onerous environmental regulations, labor laws and other hardships) that states and localities imposed on those traditional retailers in the first place. In fact, two bills have already been introduced in the Virginia Assembly that would eliminate that state’s sales tax.

Despite its growing popularity, not all the competitive advantages are held by e-commerce. Anything ordered over the Internet involves a delay between order and delivery, whereas patrons of traditional retail stores enjoy immediate receipt of their goods. Many people don’t feel comfortable ordering certain items over the Internet. Traditional retail also has the enormous advantage of personal service. Further, delivery involves shipping and handling costs, which often add as much or more to the cost of a product as would taxes.

Studies have shown that e-commerce doesn’t pose the imminent threat to traditional retailers claimed by Internet tax proponents. Although e-commerce retail sales have grown rapidly, business-to-customer (“retail”) sales over the Internet represented less than 0.3 percent of total consumer spending.<sup>27</sup> This is because the amount of wealth in the economy is not fixed. When the economy grows, a gain in one sector does not necessarily mean a loss in another. In addition, traditional retailers and Internet sellers are not mutually exclusive. Many traditional retailers have established an Internet presence, which allows them to avoid the burden of high taxation when they sell to customers outside their state. To claim that taxing the Internet will protect traditional retailers is reminiscent of the claim that the Berlin Wall protected East Berliners.

In an 1819 Supreme Court case, Chief Justice John Marshall observed that “the power to tax involves the power to destroy,”<sup>28</sup> an adage that has proven to be prescient. If the NGA and its fellow travelers are successful in their assault on the Internet, the resulting tax burden could reduce the number of online buyers by as much as 24 percent.<sup>29</sup> Highly successful online ventures like Amazon.com have not yet generated a profit and many small e-commerce start-ups are struggling to get on their feet. A 24 percent contraction in e-commerce will destroy innumerable current businesses and prevent the birth of countless others. Investors have flocked

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<sup>26</sup> *E-Quality*.

<sup>27</sup> *The Sky Is Not Falling: Why State And Local Revenues Were Not Significantly Impacted By The Internet in 1998*, Ernst & Young Economics Consulting and Quantitative Analysis, June 18, 1999 [“The Sky is Not Falling”], p. i. Available at <[http://www.ey.com/global/vault.nsf/us/Sky\\_is\\_not\\_falling/\\$file/sky.pdf](http://www.ey.com/global/vault.nsf/us/Sky_is_not_falling/$file/sky.pdf)>.

<sup>28</sup> *McCulloch v. Maryland*, 17 U.S. 316 (1819).

<sup>29</sup> *In a World Without Borders*, p. 3.

to high tech concerns based on potential future returns. Smothering this industry during its infancy through taxation will throw into serious doubt the success of many businesses on which investors have risked their money.

Not explicitly mentioned, but implicit in the NGA's argument, is the assertion that government should manage the economy to protect established enterprises by throwing up barriers against upstarts, which have often been the harbinger of greater efficiency. If this type of politically driven economic system had existed years ago, the assembly line would have been eliminated and stores like Wal-Mart and Costco, with their economies of scale, would have been crushed. While many socialist countries maintain this type of bulwark against progress and freedom, most Americans would likely blanch at the prospect of permanently high prices, no economic growth, fewer goods, high unemployment and antiquated products and services.

## Plan To Tax The Internet Is Unconstitutional

The NGA alleges that e-commerce enjoys a tax "loophole." In their furor to raise taxes where there were none before, the Internet tax proponents claim that people who disagree with them are violating the Constitution with a "federal power grab."<sup>30</sup> How the *absence* of taxation could constitute an unconstitutional power grab is anybody's guess. What the United States Supreme Court has ruled is that in order for a state to collect sales tax, the seller must have a significant presence in the taxing state. Further, the court has said that a state has no jurisdiction to require a vendor to withhold that state's sales taxes unless the vendor has a "substantial nexus," meaning a physical presence, with the taxing state.<sup>31</sup>

Unlike many other things dreamed up by Congress, prohibiting taxation on the Internet has a constitutional foundation. Article I, Section 8, Clause 3 of the U.S. Constitution (the Commerce Clause) gives Congress the authority to prohibit state actions that interfere with the free flow of interstate commerce. Article VI (the Supremacy Clause) makes it clear that when state laws conflict with each other or with national laws, federal laws prevail. Finally, in Article I, Sections 9 and 10, the Founders set forth sound principles of non discrimination in trade and taxation by noting "No tax or duty shall be laid on articles exported from any state. No preference shall be given by any regulation of commerce or revenue to the ports of one state over those of another" and "No State shall, without the consent of Congress, lay any imposts or duties on imports or exports...."

Remote taxation is taxation without representation. The prospect of allowing state and local governments to tax across their borders runs counter to the very foundation of our republic. Legitimate taxation should be strictly limited to those functions performed within a governing jurisdiction. Taxes should not be levied on or collected from people who have no say in how the revenue is spent and who receive no benefit from the services they fund.

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<sup>30</sup> *How are Washington politicians trying to violate the Constitution?*, National Governors Association. Available at <<http://www.nga.org/Internet/Federal.asp>>.

<sup>31</sup> *Quill v. North Dakota*, 504 U.S. 298 (1992).

## States And Localities Flush With Tax Revenue

The claim that state and local governments are being bled dry of sales tax revenue is baseless. Because of the exceptionally strong economy (which is being driven by the very sector the NGA seeks to shackle), state and local coffers are overflowing with tax revenue. Between 1992 and 1998, state revenues grew at almost twice the rate of inflation plus population growth.<sup>32</sup> In 1998, the 50 states closed their books with a combined surplus of \$36 billion.<sup>33</sup> In 1999, state budget reserves were at their highest level in nearly two decades.<sup>34</sup>

Even with the phenomenal growth of e-commerce, the sales and use tax that might have been collected in 1998 from remote Internet sales taxes would have amounted to only \$170 million, only one tenth of one percent of total state and local government sales and use tax collections. This is primarily because 80 percent of current e-commerce is business-to-business sales, which are exempt from sales and use taxes. In addition, 63 percent of current e-commerce business-to-consumer sales are intangible services, such as travel and financial services, or products like groceries and prescription drugs, which generally are not subject to local sales and use taxes.<sup>35</sup>

The NGA and other Internet proponents seek to take more at a time when Americans spend more per capita on taxes than food, clothing and shelter combined.<sup>36</sup> The federal tax burden alone in 2000 is projected to be only slightly less than it was at the height of World War II.<sup>37</sup> Further, any administrative costs associated with collecting payments will be borne by taxpayers.

Even if states and localities were having budget difficulties, which they clearly are not, state and local officials would be better off expending their energy to eliminate wasteful, unnecessary spending programs rather than seeking to impose new taxes. Unfortunately, as record tax revenues have poured into state coffers, state government expenditures have soared and the pressure to maintain fiscal discipline has evaporated. In an era of little inflation, state budgets grew by 4.5 percent in 1996, 5 percent in 1997, and nearly 6 percent in 1998.<sup>38</sup> Allowing government to confiscate more money from those who earn it would be like throwing gasoline on a fire.

## Privacy Would Be First Casualty of Assault

There is another feature of the NGA proposal that threatens to smother the Internet in its crib: the elimination of privacy. In order to tax a transaction, the plan states that “the tax rate

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<sup>32</sup> *The State Spending Spree of the 1990s*, Dean Stansel and Stephen Moore, Cato Institute Policy Analysis, May 13, 1999 [“State Spending Spree”], p. 3. Available at <<http://www.cato.org/pubs/pas/pa343.pdf>>.

<sup>33</sup> *Ibid.*, p. 16.

<sup>34</sup> National Governors’ Association and National Association of State Budget Officers, *The Fiscal Survey of States*, Dec. 1998. As cited in *State Spending Spree*, p. 2.

<sup>35</sup> *The Sky Is Not Falling*, p. 12.

<sup>36</sup> Tax Foundation, *The “Price of Civilized Society” Surges to \$10,298 Per Person in the U.S.* (press release), Sept. 8, 1999. Available at <<http://www.taxfoundation.org/prpcs.html>>.

<sup>37</sup> Office of Management and Budget, *Budget of the United States Government, FY2001, Historical Tables*, Feb. 2000, pp. 31-32. Available at <<http://w3.access.gpo.gov/usbudget/fy2001/pdf/hist.pdf>>.

<sup>38</sup> *State Spending Spree*, p. 3.

assignment will be made based on an individual street address.” The buyer’s address would be sent to the seller, but the address would be converted to a “geo-code” by the seller before being transmitted to the ubiquitous “trusted third party.” This geo-code would then be used by the TTP as an identifier for tax information.

Any software created for the purpose of collecting private information, converting that information into a confidential format, and transmitting it to a seller and credit card company could easily be modified to collect that information for other uses without the knowledge of buyers or sellers. Such an invasion of privacy is clearly unacceptable and runs directly counter to the Fourth Amendment to the U.S. Constitution: “The right of the people to be secure in their persons, papers and effects, against unreasonable searches and seizures, shall not be violated....” Just the threat of such invasions would have a chilling effect on the continued health of e-commerce.

## **Overwhelming Opposition to Increased Tax Burden**

In 1665, Jean Baptiste Colbert, the French finance minister and controller general under Louis XIV, observed that “the art of taxation is to pluck the most feathers from the goose with the least amount of hissing.” Americans have been plucked almost naked and are hissing quite a bit. Of the 31,805 people who have contacted the e-Commission since its first meeting in 1999, 93 percent (29,869) oppose new Internet taxes.<sup>39</sup>

## **An Alternative Focus: Reducing Current Barriers to the Internet**

Instead of concocting new ways to squeeze more money from working Americans, the NGA and others should focus their energies on productive proposals that will enhance economic growth and remove the access barriers to the Internet that already exist.

First, the federal excise tax on telecommunications should be repealed. Established in 1898 to help finance the Spanish-American War, it continued as a “luxury” tax to help pay for World War I. When state and local taxes are added to this tax, the tax rate on telecommunications services in the United States runs as high as 28.6 percent. The tax is highly regressive because low-income people are forced to spend a higher percentage of their income on this tax. In fact, excise taxes on alcoholic beverages and tobacco products have less of an impact upon low-income families than telephone excise taxes.<sup>40</sup>

Second, the hidden E-Rate tax, commonly known as the “Gore Tax” (due to the vice president’s strong support of the tax) on long distance telephone service should be eliminated. The Federal Communications Commission (FCC) required long distance companies to levy a tax on customers to fund a pet project of the vice president’s, the wiring of schools and libraries for

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<sup>39</sup> Americans For Tax Reform, *Public Comments to Net Tax Commission Running 15-To-1 Against Net Tax Schemes* (press release), Jan. 11, 2000.

<sup>40</sup> *The Distributional Effects of an Increase in Selected Federal Excise Taxes* (paper), Jan. 1987, Congressional Budget Office.

the Internet.<sup>41</sup> This burdensome tax has been forced on the American people even though private efforts to provide access to the Internet, such as those by the Bill and Melinda Gates Foundation and Channel One, have been highly successful without the use of taxpayer money.

The FCC levied the Gore Tax on the American people without the authorization of Congress. Although the FCC claims that the Telecommunications Act of 1996 granted them the authority to do so, Article I, Section 7 of the Constitution states “All bills for raising Revenue shall originate in the House of Representatives.” Rep. Tom Bliley (R-Va.), chairman of the House Committee on Commerce (which oversees the FCC and where the Telecommunications Act was written), has flatly stated, “The Gore Phone Tax is fundamentally illegal and unfair.”<sup>42</sup> The General Accounting Office (GAO) also found that the FCC had exceeded its authority.<sup>43</sup>

Third, discriminatory (ad velorem) taxation should be prohibited. Many states tax the intangible assets of public utilities, often the most valuable portion of the utility’s business, while not taxing the same assets held by other businesses. In addition, states often apply a higher tax rate to the tangible personal property held by utility companies than that held by other business taxpayers generally.<sup>44</sup>

Fourth, “franchise taxes” where states and localities levy taxes of up to 5 percent on business and consumer telecommunications use for use of public rights-of-way should be eliminated. These franchise taxes are essentially “Internet tolls” and are a barrier to greater Internet access.

Fifth, state and local telecommunications taxes, filing and auditing procedures should be simplified. Current taxes are too high, too complicated, and too numerous. Providers should be required to file only a single return to the state, representing funds collected for state and local taxes, after which the state should distribute funds back to localities. To further reduce compliance costs, only one audit per state should be permitted for any taxable period.

Finally, measures should also be taken to ensure on-line privacy. Any sales tax regime, such as the NGA plan, that requires personally identifiable information to be collected or transmitted to any government agency or surrogate should be summarily rejected.

## **Conclusion: Leave Us Alone**

A primary axiom of economics is that the more you tax something, the less you get of it. For their own parochial interests, those who wish to tax the Internet would guarantee that fewer people will gain access to a technology that is as significant to the world as the printing press more than 500 years ago.

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<sup>41</sup> *Telecommunications Discounts for Schools and Libraries: The "E-Rate" Program and Controversies*, Congressional Research Service, Issue Brief IB98040, Dec. 22, 1999 [“Telecommunications Discounts”].

<sup>42</sup> United States Representative Tom Bliley, House Committee on Commerce, *Bliley Statement On E-Rate Program* (press release), Sept. 30, 1999.

<sup>43</sup> The General Accounting Office Feb. 10, 1998 response to a Nov. 1997 request from Senator Ted Stevens (R-Alaska) as cited in *Telecommunications Discounts*.

<sup>44</sup> *50-State Study and Report on Telecommunications Taxation*, Annabelle B Canning, Committee on State Taxation, Sept. 7, 1999, pp. 12-13. Available at <<http://www.ecommercecommission.org/pubOne.cfm?ID=81>>.

The Internet has transformed the international economy and is the driving force behind our unprecedented economic growth. It has resulted in an overall decrease in prices and an increase in employment and wages. People around the world may now exchange goods, services and ideas with anyone, anywhere, at any time. Taxation would place limits on what has already proven to be one of the greatest technologies ever created. Internet taxation is not only an immediate threat to our wallets; it is an attack on progress and our future prosperity.

Proposals to tax the Internet are predicated on an intrinsic government claim on our earnings. This is reason alone to dismiss these proposals. Further, implicit in all the arguments for Internet taxation is the protection of the status quo. The government's predilection to pick winners and losers in the marketplace through the tax code (and other policies) is a cancer that should not be spread to the Internet.

Rather than looking to the past for models and policies that limit freedom, inhibit growth and increase government control over our lives, policymakers should take a lesson from the future and apply the same limited government involvement and economic liberty the Internet now enjoys.

If freedom and limited government work in cyberspace, they can work on Main Street.