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Creating an Online Internet Tax: A Complex Construction?

Isaac J. Morris*

Death and taxes and childbirth! There's never any convenient time for any of them!

—Margaret Mitchell, *Gone With the Wind* (1936).¹

I. INTRODUCTION

While the Internet was created over thirty years ago, its development took many different turns before reaching its present state.² Its creators no doubt realized its novelty, but could not predict its future.³ From email and instant messaging, to swapping music⁴ and streaming live video, the Internet has not only brought forth many innovations, but has also regenerated old ideas that have opened new avenues.⁵ One of its greater impacts is evident in online sales. In 1998, consumers purchased \$5 billion worth of goods over

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¹ MARGARET MITCHELL, *GONE WITH THE WIND* 659 (Warner Books ed., Warner Books, Inc. 1993) (1936).

² LAWRENCE LESSIG, *THE FUTURE OF IDEAS: THE FATE OF THE COMMONS IN A CONNECTED WORLD*, 41, 122-26 (2001) (noting that the creator of the World Wide Web (“WWW”) “came up with the idea . . . after increasing frustration over the fact that computers at [his lab] couldn’t easily talk to each other” and how today online books, music, film and culture databases now saturate the online market.). Lessig notes that the WWW and the Internet are in fact distinct concepts. *Id.* at 41, 44; *see also* Internet Tax Freedom Act (“ITFA”), Pub. L. No. 105-277, § 1101(e)(3)(A), (C), 112 Stat. 2681, 2719 (1998) (defining the “WWW” as the “means by placement of material in a computer server-based file archive so that it is publicly accessible, over the Internet, using hypertext transfer protocol, file transfer protocol, or other similar protocols” and delineating the “Internet” to be the collective “myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide 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.”) For ease of this paper, however, the term “Internet” will be used regardless of whether it may be more appropriate to use the term “WWW.”

³ *Cf.* Lawrence Lessig, *The Architecture of Innovation*, 51 DUKE L.J. 1783, 1789-90 (2002). “The innovation of the Internet—built into its architecture—is an innovation in the ways in which culture gets made. Let the dotcom era flame out. It won’t matter to this innovation one bit.” *Id.* at 1790.

⁴ No Internet paper would be complete without some mention of diabolical genius Shawn Fanning. While other online music services copied his idea, Napster created a paradigm shift in the way companies view online music. For a brief background of Napster’s rise and fall, see JESSICA LITMAN, *DIGITAL COPYRIGHT* 158-62 (2001).

⁵ *See* LESSIG, *supra* note 2, at 169. “The [Internet] is an open architecture; it begs for people to discover new ways to combine the resources it makes available.” *Id.* (emphasis added).

the Internet;⁶ by 2001, purchases increased to more than \$32 billion. Unfortunately, states are not taxing Internet purchases, and as a result, they are failing to take advantage of this rising stream of commerce. For example, “[i]n 1999 alone, states lost \$525 million in foregone sales taxes due to an inability to collect these taxes on Internet purchases.”⁷ These numbers increase each year, and by 2003, “states [were] predicted to forego \$20 billion due to their inability to collect [sales] taxes from out-of-state sellers conducting business over the Internet.”⁸ Because states generate nearly half of their tax revenue from sales and gross receipts taxes,⁹ the rising trend of online sales creates worry about this untapped resource.¹⁰

States are not necessarily blind to these numbers however, and the majority do require buyers to pay taxes on Internet sales,¹¹ but “few states enforce those laws.”¹² Some scholars suggest that states may not be committing a grievous error because lost revenue is far less than actually reported.¹³ Other commentators note that before taxes on Internet sales can be collected, they must deal with the U.S. Supreme Court’s holding in *Quill Corporation v. North Dakota*: “states can’t force a business to collect sales taxes unless they have a store or other physical presence in the state.”¹⁴ Finally, a belief that enforcement of these taxes will be overwhelmingly difficult seems to pervade the general

⁶ Robert W. Hahn & Anne Layne-Farrar, *Is More Government Regulation Needed to Promote E-Commerce?*, 35 CONN. L. REV. 195, 211 (2002).

⁷ Kathleen P. Lundy, *The Taxation of E-Commerce: The Inapplicability of Physical Presence Necessitates an Economic Presence Standard*, 8 RICH. J.L. & TECH. 12, 14 (2001).

⁸ Megan E. Groves, *Tolling the Information Superhighway: State Sales and Use Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 619, 619 (2000) (citing *NGA Online: Overview of Sales and Use Taxes and Electronic Commerce*, at http://www.nga.org/nga/legislativeUpdate/1,1169,C_ISSUE_BRIEF%5ED_1248,00.html (last visited Apr. 16, 2004)).

⁹ Groves, *supra* note 8, at 619 (citing *NGA Online: Sources of State Tax Revenue*). There seems to be some disparity however, in the accuracy of this number. See *States Ask Congress to Bless NetTax* [hereinafter *Net Tax*], at <http://www.cnn.com/2003/TECH/internet/09/25/net.taxes/ap/index.html> (last visited Apr. 16, 2004) (“The National Governors Association estimates sales taxes make up one-third of state tax revenue, and state and local governments fear that tax collections will decline as shoppers turn to the Internet more often”).

¹⁰ See Ian Christopher McCaleb, *States Argue for Taxing Internet Transactions*, CNN.COM, March 14, 2001, at <http://www.cnn.com/2001/ALLPOLITICS/03/14/internet.taxes/index.html> (last visited Mar. 3, 2004). “Sales taxes must be collected, some have argued, because some states do not levy income taxes on their residents -- meaning sales taxes are a principal source of income.” *Id.*

¹¹ *Net Tax*, *supra* note 9. Technically, sales taxes only occur “upon purchases . . . in the taxing state.” Groves, *supra* note 8, at 622 (citing PRENTICE-HALL, INC., PRENTICE HALL’S GUIDE TO SALES AND USE TAXES 57 (1988)). When academia and the press refer to a state requiring a buyer to pay taxes on Internet purchases, they likely mean a use tax, which occurs “outside of the geographic boundaries of the taxing state” Groves, *supra* note 8, at 622. In theory, however, the two are equivalent. See Austan Goolsbee & Jonathan Zittrain, *Evaluating the Costs and Benefits of Taxing Internet Commerce*, 52 NAT’L TAX J. 413, 413 (1999) (“If a buyer in Boston . . . orders a book from Amazon.com (located in Washington state) . . . the buyer technically owes a use tax (*equivalent to the sales tax*) on the purchase to Massachusetts”) (emphasis added). A related concept is that “[i]n most events, a purchaser will be exempt from use taxes if an applicable sales tax was paid in the state where the goods were purchased. This avoids double-taxation, and preserves competitive equilibrium between in-state and out-of-state vendors.” Anthony C. Camilli, *Run for the Border! Evasion of Sales and Use Taxes By Mail-Order and Internet Sellers*, 19 J.L. & COM. 137, 140 (1999).

¹² *Net Tax*, *supra* note 9.

¹³ Goolsbee & Zittrain, *supra* note 11, at 417 (arguing that “the revenue loss in 1998 [from lost taxes on Internet sales] . . . amounted to less than one-quarter of one percent of total state and local sales tax revenue (or 0.05 percent of total tax revenue.”)).

¹⁴ *Net Tax*, *supra* note 9 (discussing *State v. Quill Corp.*, 470 N.W.2d 203, 214 (N.D. 1991)).

public thought.¹⁵ This paper will address each of these issues in turn to demonstrate the manageable nature of constructing a workable system of taxing Internet sales.

Part II grapples with the idea that reports of lost revenue are widely exaggerated. It shows how this notion misses the bigger picture, and how a conception of present data cannot be indicative of future planning. Next, Part III scrutinizes the necessity of imposing a physical presence requirement for Internet sales taxes. It attacks not only the Supreme Court but also Congress for its lackadaisical approach to the subject. Finally, Part IV provides several straightforward solutions to the problem of collecting Internet sales taxes.

II. ENFORCEMENT OF INTERNET TAXES: COSTS V. BENEFITS

The assertion that states lose millions in uncollected Internet sales taxes receives deference from academics and politicians, but is nonetheless a disputed position. Austan Goolsbee and Jonathan Zittrain argue that loss in revenue to be highly inaccurate for several reasons:

First, . . . business-to-business [sales are] largely exempt from sales tax¹⁶ . . . Second, the predicted revenue losses ignore the possibility of trade creation. Products that might not have been purchased in a store were it not for the Internet, such as online greeting cards, should not be counted for lost revenue. Third, even if we assume that electronic commerce is entirely divisionary and that all of the commerce will be business-to-consumer, the calculations still have serious flaws by failing to account for the types of products being sold.¹⁷

Goolsbee and Zittrain note that “many computer sellers online already pay sales taxes,”¹⁸ and that “Internet sales [may] cannibalize non-taxed catalog sales rather than retail store sales.”¹⁹

¹⁵ See *Taxes Slip Through the Net*, THE ECONOMIST, May 31, 1997, at 22 (stating such reasons as the reduction of “traditional intermediaries, such as bankers and brokers, who report transactions to tax authorities,” and the prevalence of electronic money, which “can be anonymous, untraceable—and a good deal more convenient for money launderers,” will pose thorny issues for the taxman); but see Goolsbee & Zittrain, *supra* note 11, at 421 (stating that “[c]alculation of taxes . . . may be tedious, but such a task is well-suited to an electronic environment.”)

¹⁶ The import that business-to-business markets play is staggering. “By 2002, the Internet may be used for more than \$300 billion worth of commerce between businesses.” Marcelino Ford-Livene, *The Digital Dilemma: Ten Challenges Facing Minority-Owned New Media Ventures*, 51 FED. COMM. L.J. 577, 602 (1999) (quoting U.S. DEP’T OF COMMERCE, THE EMERGING DIGITAL ECONOMY 7 (Apr. 1998)) (emphasis added).

¹⁷ Goolsbee & Zittrain, *supra* note 11, at 415.

¹⁸ *Id.* at 416. One notable example of an online computer seller already collecting sales taxes is Apple (www.apple.com). The door for tax-free Apple products remains open through other online vendors, however, with CDW being one example (www.cdw.com). Even with this competition, apple.com continues to receive business possibly due to exclusive academic pricing and the safety of avoiding a third party vendor.

¹⁹ *Id.* at 416. Such a position may be tentative in light of many companies opening Internet-based stores. Cf. Paul J. Gessing, *PRO & CON Net Tax Should Congress Allow States to Tax Internet Sales to Narrow the Budget Deficits? No: States’ Bold Quest for Internet Sales Tax is Power Grab After Spending Spree of the 90s*, CHARLESTON GAZETTE, June 8, 2003. Interestingly enough, “[t]he online divisions of Wal-Mart,

¶6 The problem with attacking lost revenue, however, is that, despite possible errors in calculating exact figures, the volume of Internet business continues to increase exponentially. There can be little doubt that online purchasing has yet to reach its apex. Even if sales appear to be insignificant at present, such data is not indicative of future e-commerce. Indeed, “[r]esearchers have generally found that the adoption of new technologies is sluggish at first.”²⁰ Robert Hahn and Anne Layne-Farrar point to the dramatic growth of the debit card industry: “In 1988, 87% of all retail purchases were paid in cash and only a handful of merchants . . . even accepted debit cards By late 2001, [however,] debit cards accounted for 8.3 billion transactions worth \$348 billion.”²¹ Additional evidence shows similar trends in Internet sales.²² Hence, the revenue from e-commerce may not only increase to the level that Goolsbee and Zittrain dispute, but it may well surpass that level in the near future.

A. *The Mirage of Small Numbers*

¶7 Even if current data points to smaller sums of online sales tax revenue, such evidence does nothing to dispute the validity of the claim that significant revenue is being lost. Goolsbee and Zittrain attempt to invalidate these calculations, stating that “[t]he existence of untaxed catalog sales has not bankrupted state budgets and for the next several years, online sales are likely to be considerably smaller than mail-order sales [were] even decades ago.”²³ They then assert that the “costs of [Internet sales] enforcement [may] . . . be better applied elsewhere in the short run.”²⁴

¶8 While the Goolsbee-Zittrain argument highlights the uncertainty of revenue loss, it reaches dubious conclusions by making an incorrect analogy between Internet sales taxes and catalog sales taxes, and by disfavoring the timely implementation of an Internet sales tax system. First, the fact that states avoid bankruptcy without collecting tax on catalog sales misses the point entirely. To be sure, states certainly want this revenue, and in an era of overwhelming budget deficits, states may in fact *need* this revenue. For example, in 2004 California faces a massive \$38 billion budget deficit.²⁵ Even if the collection of Internet sales tax only amounted to several million dollars now, it would still be *additional* revenue. Governor Arnold Schwarzenegger ran a successful campaign built in large part on his promise to solve the deficit problem.²⁶ If “politics-as-usual” must lose, there seems to be no reason not to embrace lost sources of revenue.

Target and several other major brick-and-mortar retailers have voluntarily decided to collect taxes on sales via their Web sites.” *Id.*

²⁰ Hahn & Layne-Farrar, *supra* note 6, at 207.

²¹ *Id.* at 208-09.

²² *Id.* at 209-12; *see also infra* notes 109-11 and accompanying discussion.

²³ Goolsbee & Zittrain, *supra* note 11, at 417-18.

²⁴ *Id.*

²⁵ Alorie Gilbert, *California Budget Crisis to Hit IT*, NEWS.COM, July 30, 2003, at <http://news.com.com/2100-1012-5058055.html> (last visited March 4, 2004).

²⁶ *Cf. Arnie! Arnie!: A Comfortable Victory, But A Lot of Promises to Keep*, THE ECONOMIST, Oct. 11, 2003, at 29-30. The possibility exists that Governor Schwarzenegger will not enact the Internet sales tax because it could be construed as an *increase* in taxes, something which Schwarzenegger promised to avoid, even though it would only capture taxes to which California is legally entitled. Regardless of the public perspective, such a prognosis would not necessarily undermine Governor Schwarzenegger’s prospect of a second term in office. It should be remembered that “a former movie actor who became a Republican governor of California also promised not to raise taxes, raised them, and went on to become president.” *Id.*

¶9 States facing less severe budget shortfalls stand to gain even more from an Internet sales tax. Current estimated budget deficits for Florida and Tennessee stand at \$2 billion and \$500 million respectively.²⁷ With a total of forty-nine states in the red,²⁸ there is no better time to reexamine revenue sources. Furthermore, not only will raw dollar numbers of Internet sales increase, but the growth of the whole industry may begin to account for a larger portion of total sales tax revenue—a point that Goolsbee and Zittrain reluctantly acknowledge.²⁹ Indeed, even if Internet sales are comparatively small, online sales are still growing “much faster than total retail sales: 2001 [Internet sales] increased 19.3% over 2000 while total retail sales only increased 3.3%,” suggesting that online purchasing may be growing at a very high rate.³⁰

¶10 State budget crises become even more of a factor when considering long-term strategies. “Thanks to weak revenues and harmful federal policies, stated budget deficits will persist until at least fiscal 2005, when states will still face collective budgetary gaps exceeding \$40 billion for that year.”³¹ While cuts in spending will no doubt be used to cure such ills, they will likely be joined with tax increases,³² and states with balanced budget amendments will scramble to conserve their resources. The mantra that “drastic times call for drastic measures” may not have to apply where states are willing to implement and enforce sales taxes on e-commerce.

¶11 Finally, the argument that potential revenue collection from Internet sales taxes is too small ignores basic economics. As long as the tax revenues from Internet sales collected by State governments outweigh the associated costs, there will be a profit. The only economic reason not to collect these taxes would be if the costs were prohibitive.³³ Initial start-up costs, regardless of amount, would of course be borne just once. A more relevant analysis would focus on whether actual operating costs would impose any significant burdens on the system.³⁴ As Richard Posner notes, “[the] government

at 30.

²⁷ *Budget Deficits*, AUGUSTA CHRONICLE, June 20, 2003.

²⁸ Currently, Wyoming is the only state with a budget surplus. See Robert W. Black, *State Budget Surplus Up by \$33M*, THE CASPER STAR-TRIBUNE, Jan. 14, 2003, available at <http://www.casperstartribune.net/articles/2003/01/14/news/wyoming/e30b6cf0413049c8d5a4e9f78271d354.txt> (last visited Mar. 4, 2004).

²⁹ “If the growth rate of online retail commerce continues at 70 percent per year after 2003, by 2007 the revenue loss would amount to as much as ten percent of total sales tax revenue It is the possibility of these extreme losses, albeit well into the future, that makes the issue of enforcement so politically sensitive today.” Goolsbee & Zittrain, *supra* note 11, at 418.

³⁰ Hahn & Layne-Farrar, *supra* note 6, at 211.

³¹ Matthew Vadum, *State Budget Deficits Will Top \$40 Billion in 2005, Analyst Says*, THE BOND BUYER, Oct. 24, 2003, at 5.

³² Of course, the implementation of an Internet sales tax would not be a panacea for state budget deficits. See *id.* (stating that the Cato Institute blames “states’ current financial problems primarily on out-of-control spending that state legislators approved in the 1990s,” while Iris J. Lave “blames the deficits largely on ‘over-exuberant’ tax-cutting by states in that decade.”) Nevertheless, by not collecting taxes from Internet sales, states overlook a means of somewhat alleviating their budgetary woes.

³³ Cf. EDWIN G. DOLAN & DAVID E. LINDSEY, *ECONOMICS* 605 (5th ed. 1988)

If the increase in revenue exceeds the increase in cost (that is, if marginal revenue is greater than marginal cost), boosting output by one unit increases total profit. . . . It follows that in order to maximize profit, a firm should expand its output as long as marginal revenue exceeds marginal cost

Id.; FREDERICK S. WEAVER, *ECONOMIC LITERACY: BASIC ECONOMICS WITH AN ATTITUDE* 53 (2002) (“As long as the firm’s increased output and sales generate additional revenues (marginal revenues) greater than the associated increased costs (marginal costs), total profits rise.”)

³⁴ Cf. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW*, 339 (5th ed. 1998). “If we ask not how large a

generally lacks the discipline of competition and the incentive of profit maximization.”³⁵ Here, however, because states control the demand for Internet sales only indirectly through taxes, they cannot truly affect the popularity of online purchases. Indeed, the notion that taxes will drastically affect online spending appears to be premature at most. A 1999 “CIO magazine study [reported] that seventy-one percent of consumers [would] not alter their online spending if sales and use taxes [were] imposed on goods and services purchased over the Internet.”³⁶ States have every incentive to collect taxes and decrease their costs associated with tax collection.³⁷ Keeping costs low, while Internet sales increase, will create a more profitable Internet sales tax system.

¶12 In the end, proving the economic soundness of an Internet sales tax collection system depends on data not yet available: the estimated costs of collection. Once this number is known, states will be free either to rely on previously reported estimates of potential revenue collection, or to undertake more scrupulous analysis of the online market. Until more scrutiny is given to this data, governments and academics can only conjecture as to how much could be gained.

¶13 Opponents to online sales taxes may speculate, however, that even if states have incentives to decrease administrative costs, there is nothing to prevent a state from levying exorbitant sales taxes. “According to the theory of competitive federalism [however], competition among governments will constrain governments from overcharging or over-regulating.”³⁸ This theory already finds strong support in land use controls.

If a municipality uses exactions to overregulate or overcharge, the developer will take, or threaten to take, its capital elsewhere: from the overreaching community to another community, from the residential market most often affected by exactions to the commercial market, or from the building market to other forms of investment.³⁹

new entrant’s start-up costs would be but how large the ratio of start-up to operating costs—in other words, of fixed to variable costs—would be then we shall identify a real problem of entry.” *Id.*

³⁵ *Id.* at 509.

³⁶ Groves, *supra* note 8, at 620.

³⁷ The analogy to perfect competition, though not quite “perfect,” does provide a useful comparison. “[A] perfectly competitive market is composed of a large number of firms that are so small relative to the size of their market that they cannot influence price.” WEAVER, *supra* note 33 at 53-54. Such firms “are price takers . . . [because] the price at which each firm sells its output is determined by forces beyond the firm’s control; the price is set by supply and demand conditions in the market as a whole.” DOLAN & LINDSEY, *supra* note 33, at 603. The fact that prices are set, however, does not mean that businesses cannot increase profits. Decreasing costs, even with static prices, will enlarge the bottom line. (For purposes of this footnote, and in order to avoid an in-depth discussion of microeconomics, this example assumes that a company decreasing costs would not also decrease price and destroy the state of perfect competition). The government faces a similar situation. While it is not in competition with other entities for tax collection, the taxing effect is small enough that there is substantial difficulty in influencing price. *See supra* note 36 and accompanying discussion. The amount of output, or Internet sales, is determined by forces beyond the government’s control and there is every incentive to decrease costs.

³⁸ Vicki Been, “Exit” as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 COLUM. L. REV. 473, 506 (1991).

³⁹ *Id.* at 511.

¶14 The same idea holds true with online sales taxes. State and local governments face competition from neighboring jurisdictions. To prevent people from voting with their feet, states have strong incentives to balance tax rates with revenue collection.

¶15 Finally, if costs do end up negating revenues, states should nevertheless strongly consider the implementation of Internet sales tax systems.

B. No Time Like the Present

¶16 Any lost revenue from untaxed catalog sales proves why a system of taxing Internet sales must be implemented sooner than later. When taxes are not immediately collected, the perception is created of a tax-free avenue. This becomes the norm for both the tax payor as well as the tax collector. As Goolsbee and Zittrain state, “[w]hen Internet sales account for, say 10 or 20% of total retail sales, [some people] believe it may be difficult to put the genie back in the bottle.”⁴⁰ So while it may be true that Internet sales account for a small portion of sales overall that *further validates* the idea that the sooner the Internet sales tax becomes a reality, the more willing businesses will be to accept it.⁴¹

¶17 Goolsbee and Zittrain counter this argument by suggesting that numbers may not justify such a decision, and that *for now*, such worries are unwarranted.⁴² Still, the logical rebuttal is that *sooner* is better than *later*. Twelve years ago, “[e]stimates of lost revenues attributable to the inability of states to enforce use tax collection duties [on mail-order sales] range[d] from \$694 million to \$3 billion per year.”⁴³ As these numbers multiply, it will become increasingly more difficult to implement a sales tax system; the logistics of putting such a system into operation is far easier when a smaller market is affected.

C. The Proper Target

¶18 Voluntary tax payments by individuals are inadequate as compared to the revenue lost not—or by belatedly—taxing e-commerce. Unsurprisingly, “[c]onsumers do not generally understand that they have an obligation to pay use taxes.”⁴⁴ The taxing authorities of a State are then left standing in an unenviable position: in order to collect these revenues, they will have to increase expenditures to conduct individual audits.⁴⁵

⁴⁰ Goolsbee & Zittrain, *supra* note 11, at 418.

⁴¹ Timothy Fallaw, Note, *The Internet Tax Freedom Act: Necessary Protection or Deferral of the Problem?*, 7 J. INTELL. PROP. L. 161, 186 (1999) (noting that “[a] possibility exists that after three years of tax freedom [under the IFTA], taking [the] benefit away from the unwilling industry will be difficult” and that the “long period of immunity from taxation will likely lead to an ardent effort on the part of the Internet industry to make the moratorium permanent.”).

⁴² “The data suggest . . . that for the next several years . . . there is little revenue to be gained from enforcing taxes on Internet sales.” Goolsbee & Zittrain, *supra* note 11, at 418.

⁴³ Timothy H. Gillis, Note, *Collecting the Use Tax on Mail-Order Sales*, 79 GEO. L.J. 535, 538 (1991).

⁴⁴ Val John Christensen, *Leveling the Playing Field: A Business Perspective on Taxing E-Commerce*, 2000 BYU L. REV. 139, 143 (2000). Mr. Christensen makes the bold statement that “[consumers] see sales taxes as a *legitimately* avoidable part of the purchase price.” *Id.* (emphasis added). *But see* Camilli, *supra* note 11, at 162-63 (asserting that it is patently speculative whether “imposing tax collection duties on out-of-state vendors . . . would hurt sales,” and backing that statement with “a Gallup survey [which] found that seventy-eight percent of all mail-order customers view sales tax as totally irrelevant.”).

⁴⁵ Camilli, *supra* note 11, at 147-48.

The prohibitive costs of such audits, coupled with the predictably miniscule rewards, lead most jurisdictions to scrap such ideas.⁴⁶

¶19

Decreasing enforcement expenditure is not the only economic reason states would benefit from collecting Internet sales taxes directly from online companies. If businesses and governments are truly concerned with efficiency, then the vendor becomes the logical choice for both the collector and dispatcher of sales taxes. Cost-internalization theory supports this argument. Harold Demsetz, who developed the cost-internalization theory for property rights,⁴⁷ “hypothesized that [such] rights emerge when some change in the relative value of resources occurs that makes it cost-effective to internalize costs that previously were experienced as externalities.”⁴⁸ In other words, “[t]he Demsetz thesis can be seen as an anticipation of the idea that the common law evolves toward efficient rules.”⁴⁹ Having a truly efficient system, or at the very least trying to approximate such a system, requires that cost-internalization be borne by the party most able to bear that cost.⁵⁰ Otherwise, avoidable inefficiencies are created and extra costs are added to the system. While there seems to be little dispute that states may force consumers to pay use taxes on out-of-state purchases, this creates inefficiencies. The cost of enforcement against consumers outweighs the cost of enforcement against online business. Moreover, penalties and fees charged to companies for noncompliance of sales tax remittance would create a stronger shift in the business community than in the general population.⁵¹ The logical conclusion therefore, is to transfer the costs from the state and consumer to the business.

III. THE UBIQUITOUS PRESENCE OF THE INTERNET

¶20

The idea that most states may enact laws requiring Internet purchasers to pay use taxes seems inconsistent with the fact that most states cannot require an online company to collect sales taxes. Why go after thousands of individuals when focusing on several large businesses would produce the same result? Both the Supreme Court and Congress conveyed garbled answers on why such taxes are not possible, and neither branch shows any sign of revising their decisions.

⁴⁶ E.g., Megan E. Groves, Note, *Where There's a Will, There's a Way: State Sales and Use Taxation of Electronic Commerce*, 74 IND. L.J. 293, 310 (1998) (“States generally do not attempt to catch purchasers who fail to report use tax liabilities.”).

⁴⁷ Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967).

⁴⁸ Thomas W. Merrill, *Introduction: The Demsetz Thesis and the Evolution of Property Rights*, 31 J. LEGAL STUD. 331, 332 (2002).

⁴⁹ *Id.* at 331. The transfer of Demsetz’s theory from merely exclusion relating to property rights to other legal topics receives support from many academics, though it is debatable whether the argument should be taken that far. *See id.* at 333-34.

[If Demsetz’s theory applies] to any institution that functions to internalize externalities, which would cover many forms of state ownership, *government regulation*, and private contracting as well as conventional property, . . . then the thesis would be tantamount to saying that virtually all law tends to evolve in the direction of promoting efficiency—a kind of public-interest theory of regulation.

Id. at 333 (emphasis added).

⁵⁰ “[T]he incentives of private individuals are socially efficient when costs and benefits are fully internalized, whereas incentives are inefficient when some costs and benefits are externalized.” Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L.R. 1, 3 (1985).

⁵¹ *Supra* text accompanying notes 46-47.

A. *Passing the Buck*

¶21 Approximately ten years ago, the Supreme Court quashed the logical approach to state sales taxes of Internet purchases in *Quill Corporation v. North Dakota*.⁵² The facts appear quite simple. North Dakota wanted to collect sales taxes from Quill, a mail-order office supplies company, whose sales to approximately 3,000 North Dakota customers totaled \$1 million.⁵³ However, Quill retained no “physical presence” in North Dakota.⁵⁴ On this basis, the majority opinion⁵⁵ denied North Dakota the power to collect taxes from out-of-state vendors.⁵⁶

¶22 The majority opinion relied on precarious precedent and outdated logic to support its position. It began by stating that review of “state taxing statutes to out-of-state sellers” requires an examination of the statute under both the Due Process Clause as well as the Commerce Clause.⁵⁷ The opinion referred to classic notions of “fair play and substantial justice,” reaffirming that a corporation may become subject to a state’s jurisdiction without ever having a physical presence in that state.⁵⁸ Over the years, the Court has often rejected formalistic tests, and focused instead on flexible inquiries, which allow courts to consider the facets of particular cases. This flexibility allowed familiar analysis of due process and jurisdiction to be applied directly to Internet Sales. Justice Stevens emphasized the importance of flexible standards: “In ‘modern commercial life’ it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: The requirements of due process are met irrespective of a corporation’s lack of physical presence in the taxing State.”⁵⁹

¶23 Even though Quill’s contact with North Dakota residents was “*more than* sufficient for due process purposes,”⁶⁰ the same level of activity failed to meet the majority’s requirements under the Commerce Clause.⁶¹ The Court noted that while “[d]ue process centrally concerns the fundamental fairness of governmental activity, . . . the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.”⁶² Worries arose over the dormant commerce clause and whether states taxing e-commerce would unduly burden national commerce.⁶³

⁵² *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁵³ *Id.* at 302.

⁵⁴ *Id.* at 302, 306. While the Court provided no exact definition of “physical presence,” it gave simplistic examples such as “the presence of sales personnel in the State[,] . . . the maintenance of local retail stores in the State . . . [or] all of the seller’s in-state solicitation . . . performed by independent contractors.” *Id.* at 306.

⁵⁵ Justice Stevens authored the majority opinion. With respect to Parts I, II and III, the decision was unanimous. Justice White dissented from Part IV, and Justice Scalia, joined by Justices Kennedy and Thomas, concurred in the judgment of Part IV. *Id.* at 319-20, 321-22.

⁵⁶ *Id.* at 321-22 (White, J., concurring in part and dissenting in part).

⁵⁷ *Id.* at 305.

⁵⁸ *Id.* at 306-09.

⁵⁹ *Id.* at 308.

⁶⁰ *Id.* at 308 (emphasis added).

⁶¹ *Id.* at 312-13.

⁶² *Id.* at 312.

⁶³ Lundy, *supra* note 7, ¶ 17 (“While the Due Process Clause is concerned with the government treating persons fairly, the dormant Commerce Clause instead focuses on whether a state regulation places an undue burden upon interstate commerce.”).

¶24 The difficulty of the majority's reliance upon the dormant commerce clause came from its inability to recognize its anachronism. In a review of U.S. Supreme Court Commerce Clause decisions, the North Dakota Supreme Court "concluded that those rulings signaled a retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach."⁶⁴ Bewilderingly, the U.S. Supreme Court's majority explicitly agreed, yet continued to impose a bright-line test of physical location. Even though the Court touted its due process analysis, it refused to fully acknowledge its outdated approach to the Commerce Clause, stating that *stare decisis* bound it to follow *National Bellas Hess, Inc. v. Department of Revenue of Illinois*,⁶⁵ and to mandate a physical presence requirement for Commerce Clause scrutiny.⁶⁶ However, the Court noted "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today."⁶⁷

¶25 Both Justice White in his dissent and North Dakota took issue with the majority's interpretation of *Complete Auto Transit, Inc. v. Brady*.⁶⁸ The former argued that under its holding, current Commerce Clause jurisprudence disaffirmed the physical presence requirement,⁶⁹ and overruled any "sort of physical-presence nexus suggested in *Bellas Hess*."⁷⁰ Moreover, Justice White berated the majority for its specious reasoning.⁷¹ "Perhaps long ago a seller's 'physical presence' was a sufficient part of a trade to condition imposition of a tax on such presence. But in today's economy, physical presence frequently has very little to do with a transaction a State might seek to tax."⁷² Why the majority turned a blind eye to such a conclusion is puzzling; it was more than willing to recognize the anachronism of requiring a physical presence under the Due Process Clause. The confusion increases in light of the Court's own conflicting precedent.

⁶⁴ *Quill*, 504 U.S. at 314 (quoting *State v. Quill Corp.*, 470 N.W.2d 203, 214 (N.D. 1991)).

⁶⁵ 386 U.S. 753 (1967).

⁶⁶ *Cf. Lundy, supra* note 7, ¶ 16 (noting that, by abandoning a rigid physical presence requirement, it is not due process that poses a "significant obstacle to states implementing collection duties upon out-of-state Internet vendors, [but rather] [t]he Commerce Clause remains the primary hurdle for such state interests").

⁶⁷ *Quill*, 504 U.S. at 311. *But cf. id.* at 320 (where Justice Scalia capitulates to precedent, stating that "[w]e have long recognized that the doctrine of *stare decisis* has 'special force' where 'Congress remains free to alter what we have done' . . . [m]oreover, the demands of the doctrine are '*at their acme* . . . where reliance interests are involved") (emphasis added) (quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-73 (1989), and *Payne v. Tennessee*, 501 U.S. 808, 828 (1991)).

⁶⁸ While Justice White concurred in Parts I, II and III of the decision, he dissented with respect to Part IV, rejecting the notion that the Commerce Clause mandated a physical presence requirement. *Id.* at 321-22.

⁶⁹ *Id.* at 303-04, 323.

⁷⁰ *Id.* at 304. Justice White takes issue with other interpretations of precedent as well. *See id.* at 323-24 (noting that *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), did not reaffirm the continuing validity of *Bellas Hess*, but instead held that the "requisite nexus for requiring an out-of-state seller . . . to collect and pay the use tax is . . . simply whether the facts demonstrate 'some definite link, some minimum connection, between (the State and) the *person* . . . it seeks to tax") (alteration in original). Apparently, other countries have shared Justice White's bewilderment over the physical presence requirement. *See Taxes slip through the Net, supra* note 15 ("Under a quirk of American law, mail-order firms are usually exempt from state sales taxes if the buyer is in a different state.").

⁷¹ Perhaps the majority should have followed the approach of Justice Scalia, who argued "that the . . . holding of *Bellas Hess* should not be overruled," but followed "on the basis of *stare decisis*." *Quill* 504 U.S. at 320 (Scalia, Kennedy & Thomas, JJ., concurring in part and concurring in the judgment). While the outcome would have been just as illogical, it would have given Justice White less ammunition for his attack.

⁷² *Id.* at 327-28.

It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. “It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.”⁷³

¶26 By requiring a physical presence standard, the court exempts corporations from state taxation and relieves them of this justifiable burden.⁷⁴

B. Current *Quill* Analysis

¶27 Applying the *Quill* analysis today presents the same difficulties as when the ruling was originally announced. States must satisfy the two-pronged requirement of due process and commerce clause jurisprudence.⁷⁵ Fortunately, the Internet does not require any new law; the lower courts have long built up a consistent body of precedent.⁷⁶

¶28 *Zippo Manufacturing Company v. Zippo Dot Com, Inc.* is the definitive analysis of online commerce that rises to the requisite level for personal jurisdiction.⁷⁷ The Zippo Manufacturing Corporation, “well known [for its] ‘Zippo’ tobacco lighters,”⁷⁸ brought suit for trademark infringement due to the defendant’s use of the word “Zippo” in its websites.⁷⁹ The defendant replied in part by moving to dismiss for lack of personal jurisdiction.⁸⁰

¶29 After a review of constitutional limitations, the opinion noted that “the law concerning the permissible scope of personal jurisdiction based on Internet use is in its infant stages. The cases are scant.” Judge McLaughlin moved forward nonetheless, and promulgated a sliding scale approach to Internet jurisdiction as follows:

At one end the spectrum are situations where a defendant clearly does business over the Internet. . . . At the opposite end are situations where a

⁷³ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288 (quoting *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 108 (1975)).

⁷⁴ If Justice Scalia really respects *stare decisis*, this truism from *Western Livestock* must also be respected. A counter argument may be that consumers are already required to pay and submit use taxes to the state. But this argument lacks substance because requiring a business to pay the tax produces the same results and generates more efficient outcomes. See *supra* notes 46-49 and accompanying discussion.

⁷⁵ Whether or not the test truly has two prongs is open to some debate. The Supreme Court itself acknowledges this ambiguity. See *Quill* 504 U.S. at 313 n.7 (“We have sometimes stated that the ‘*Complete Auto*’ test, while responsive to Commerce Clause dictates, encompasses as well . . . due process requirement[s],” and that “such comments might suggest that every tax that passes contemporary Commerce Clause analysis is also valid under the Due Process Clause” (alteration in original) (citations omitted)).

⁷⁶ For whatever reason, this precedent is apparently not supported by the United States Supreme Court. See Note, A “*Category-Specific*” Legislative Approach to the Internet Personal Jurisdiction Problem in U.S. Law, 116 HARV. L. REV. 1617, 1635 (2004) (asserting that “there will be no uniform, national test for websites until the U.S. Supreme Court adopts one”). As can be seen from the discussion, the lower courts seem to be handling the situation without too many problems, so perhaps the Court’s explicit approval is just not necessary.

⁷⁷ 952 F. Supp. 1119 (W.D. Pa. 1997). Although only a district court case, the legal logic and construction of the opinion has been widely cited. See *infra* note 86.

⁷⁸ *Zippo*, 952 F.Supp. at 1121.

⁷⁹ *Id.*

⁸⁰ *Id.*

defendant has simply posted information on an Internet Web site which is accessible to users in foreign jurisdictions. . . . The middle ground is occupied by interactive Web sites where a user can exchange information with the host computer.⁸¹

¶30 Furthermore, *Zippo* states that personal jurisdiction under the first two situations is straightforward, with the first allowing jurisdiction and the second denying it.⁸² The court then determines jurisdiction in the “middle ground” by “examining the level of interactivity and commercial nature of the exchange of information that occurs on the Web site.”⁸³ The opinion’s attempt to adhere to the Due Process Clause is strengthened by its reliance on *World-Wide Volkswagen Corp. v. Woodson* and *Burger King Corp. v. Rudzewicz*.⁸⁴

¶31 The effects of the *Zippo* analysis have been felt in the majority of jurisdictions across the country because the Internet *did not* require a distinct form of jurisdiction.⁸⁵ “Courts have [already] applied existing laws to the world of Cyberspace in numerous non-tax contexts, including personal jurisdiction, criminal law, and intellectual property.”⁸⁶ Such an approach to jurisdiction and Internet sales tax laws is only logical in order to “negate any tax neutrality between traditional, mail-order, and Internet purchases.”⁸⁷ Notwithstanding the questionable physical presence of online businesses, lower courts have “legally controlled” the Internet—without stymieing its progression—by not mandating a bright-line test.

¶32 Despite the rational approach of *Zippo*, the Supreme Court continues to emphasize physical presence. This ignores the many “technological advances that may render such adherence inappropriate.”⁸⁸ The combination of tax neutrality, sophisticated software, lost revenue, economic efficiency, and the existence of Internet sales tax systems already in place by particular companies⁸⁹ shows how antiquated *Quill* has become.⁹⁰

⁸¹ *Id.* at 1124. *Contra* Millennium Enterprises, Inc. v. Millennium Music, LP, 33 F. Supp. 2d 907 (D. Or. 1999) (denying *general* jurisdiction where the online purchase consisted of a single CD).

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* at 1126-27. In doing so, *Zippo* establishes a framework that comports with traditional notions of fair play and substantial justice. *See* Int’l Shoe Co. v. Washington, 326 U.S. 310 (1945); *see generally* Stewart v. Hennessey, 214 F. Supp. 2d 1198 (D. Utah 2002) (applying and examining *Zippo* through the lens of Supreme Court jurisprudence and finding its model to fit accepted policy).

⁸⁵ *See e.g.*, Gator.Com Corp. v. L.L. Bean, Inc., 341 F.3d 1072 (9th Cir. 2003); Carefirst Of Md., Inc. v. Carefirst Pregnancy Ctrs., Inc., 334 F.3d 390 (4th Cir. 2003); Toys "R" Us, Inc. v. Step Two, S.A., 318 F.3d 446 (3d Cir. 2003); Revell v. Lidov, 317 F.3d 467 (5th Cir. 2002); Neogen Corp. v. Neo Gen Screening, Inc., 282 F.3d 883 (6th Cir. 2002); Soma Med. Int’l v. Standard Chartered Bank, 196 F.3d 1292, 1296 (10th Cir. 1999); InfoSys Inc. v. Billingnetwork.com, Inc., No. 03 C 3047, 2003 WL 22012687 (N.D. Ill. Aug. 27, 2003); Swarovski Optik N. Am. Ltd. v. Euro Optics, Inc., C.A. No. 03-090ML, 2003 WL 22014581 (D.R.I. Aug. 25, 2003); Hartoy Inc. v. Thompson, No. 02-80454-CIV, 2003 WL 21468079 (S.D. Fla. Jan. 29, 2003); Blumenthal v. Drudge, 992 F. Supp 44 (D.D.C. 1998); Smith v. Hobby Lobby Stores, Inc., 968 F. Supp. 1356 (W.D. Ark. 1997).

⁸⁶ Lundy, *supra* note 7, at ¶ 27 (“Jack Goldsmith, a professor at the University of Chicago Law School and scholar in the field of cyberlaw, believes existing laws can be successfully applied to Cyberspace, although they may require some tweaking and slight adaptations”).

⁸⁷ *Id.* *See also infra* note 114 and accompanying discussion.

⁸⁸ Lundy, *supra* note 7, at ¶ 30.

⁸⁹ *See infra* notes 100-05 and accompanying discussion.

⁹⁰ Kathleen Lundy also notes that “the promise of states’ simplifying their tax laws ensures that state laws requiring businesses to collect sales and use taxes will not unduly burden interstate commerce.” Lundy,

Furthermore, the Court’s assertion that Congress is free to change the system ignores the responsibility of the Court to attempt to resolve legal inconsistencies.⁹¹

C. Congress and the Ostrich Theory

- ¶33 While Supreme Court rulings effectively bind the hands of more progressive lower courts, Congress—though aware and empowered to act—continues to don blinders, as evidenced by its renewal of the Internet Tax Freedom Act (IFTA).⁹² Passed under President Clinton in 1998, this legislation aimed to “develop. . . a system which [would] accommodate the state and local needs for revenue without placing an undue burden on the development of the Internet as a major channel of international commerce.”⁹³
- ¶34 The IFTA’s implementation occurred due to “federal concerns of multiple state and local taxation killing the Internet before it [had] a chance to firmly establish itself.”⁹⁴ The necessity of such protection, however, is debatable. “[T]he Internet . . . has grown enormously in recent years with minimal government regulation.”⁹⁵ The market itself may have provided even better growth than the government.⁹⁶ This protectionist argument erodes further when the noted exemptions are considered. The IFTA’s grandfather clause allowed the District of Columbia, Colorado, Connecticut, Iowa, New Mexico, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin to continue their taxation of Internet access services,⁹⁷ based on estimated revenue losses of “approximately \$50 million.”⁹⁸ Whatever its intent, this exception failed to harm either Internet use generally or e-commerce in particular. This calls into question the necessity of the IFTA, suggesting that the Act is more paternalistic than reasonable. While it may be true that *only* twelve states receive the exemption, “the twelve jurisdictions in this group comprise *twenty percent* of the United States’ national economy [!]”⁹⁹
- ¶35 Hence, the intent of Congress backfired. Instead of providing solutions, “[IFTA] merely exacerbate[d] the current situation by attempting to defer consideration of the problem to a later date. Without this protection, Internet corporations and state

⁹¹ *supra* note 7, at ¶ 33.

⁹² *Infra* note 99 and accompanying discussion.

⁹³ “On November 15, 2001, the Senate passed the Internet Tax Nondiscrimination Act that extends the moratorium on Internet access taxes, and multiple discriminatory taxes on Internet commerce, for two years,” and “. . . noticeably excludes discussion of remote sellers collecting sales taxes on Internet purchases” Lundy, *supra* note 7 at 44. Due to the silence on the matter of online sales taxes, the new Act is no more helpful than the old. If the purpose of these Acts is *not* to stop states from collecting Internet sales taxes, *another* statute needs to be enacted allowing states that action. See *infra* note 118 and accompanying discussion.

⁹⁴ Fallaw, *supra* note 41, at 161.

⁹⁵ *Id.* at 163.

⁹⁶ Richard E Wiley, *Communications Law Overview: Recent Developments in Convergence, Competition and Consolidation*, 597 PLI/PAT 395, 420 (2000).

⁹⁷ Cf. James B. Speta, Book Review, *A Vision of Internet Openness by Government Fiat*, 96 Nw. U. L. REV. 1553, 1555 (2001) (noting that overall, markets encourage innovation better than the government).

⁹⁸ Fallaw, *supra* note 41, at 169; see also Camilli, *supra* note 11, at 156

...[T]he IFTA contains an exemption for states that already taxed Internet access and either (1) an Internet access provider had reason to know that the existing tax statute was interpreted so as to include Internet access; or (2) the state or locality generally collected such tax on charges for Internet access.

⁹⁹ Fallaw, *supra* note 41, at 169.

⁹⁹ *Id.* (emphasis added).

governments would both have [had] a sense of urgency in coming together to hammer out a deal.”¹⁰⁰

¶36 Congress must be proactive in overruling the Supreme Court, a point which Justice Stevens’ opinion made explicit. “No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions . . . [and] decide . . . to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”¹⁰¹ At least Congress seems to be in favor of not prohibiting states from collecting such revenue. In the recent debate on whether to turn the “temporary moratorium on taxes on Internet access into a permanent ban . . . [t]he only thing that both [Democrats and Republicans] agree on . . . is that the bill has nothing to do with banning taxes on online purchases.”¹⁰² The recognition by Congress of access taxes and its refusal to consider sales taxes illustrates its ineffective attempt to improve the situation. In fact, the proposed bill tries to take away the right of the “exempted states” to continue taxing Internet access.¹⁰³

¶37 Congress needs to recognize the importance of creating an Internet sales tax system States simply want the opportunity to put such a system into place. The sooner they are given the opportunity, the sooner states and the business community can work together on its implementation.

IV. MISCONCEIVED DIFFICULTIES

¶38 Adversaries who peddle the idea that Internet sales taxes will unduly burden online transactions are either guilty of willful ignorance, or do not grasp the simplicity of the solution. Internet companies are not starting with a *tabula rasa* when it comes to paying state taxes. In fact, “it goes without mentioning that online retailers pay a myriad of other taxes to the states each day—including major levies on property, payroll and income.”¹⁰⁴

¶39 Moreover, while existing systems, like cooperative agreements, may appear to be less burdensome to online transactions, they create an unnecessary third party in sales tax collection. They further lose their appeal when all fifty states become involved. Clearly, a system of Internet sales taxes is the better solution. While this does not mean such a collection system is effortless, it does help to re-focus the inquiry. When talking of difficulties, valid analysis begins by examining past practices for comparison as well as what may already be taking place.

A. Current Problems

¶40 A look at some attempted solutions demonstrates their ineffectiveness and why a state-based system of online sales tax collection would be beneficial. First, having

¹⁰⁰ *Id.* at 189.

¹⁰¹ *Quill*, 504 U.S. 318.

¹⁰² John Schwartz, *Senate Debate Due on Internet Tax Bill*, N.Y. TIMES, Nov. 6, 2003.

¹⁰³ Schwartz, *supra* note 102. The movement to permanently ban Internet access later imploded due to the ambiguous definition of “Internet access.” However, “[t]he proponents of the permanent ban offered a compromise—a temporary extension of the ban for about 5 years, as long as the new bill treats all Internet technologies equally.” Associated Press, *Internet Tax Ban Stalls Dead in Senate*, N.Y. TIMES, Nov. 7, 2003. What remains unclear from this compromise is whether the exempted states would continue to receive the benefit of the grandfather clause.

¹⁰⁴ Gessing, *supra* note 19.

consumers collect use taxes through individual audits is simply not cost feasible.¹⁰⁵ Second, other state-driven systems—such as cooperative agreements between states—are often ineffective. Cooperative agreements operate by “each state [agreeing] that if an out-of-state buyer makes a purchase from a vendor within their state, the vendor will collect and remit the applicable use-tax to the state where the buyer has the purchase delivered.”¹⁰⁶ Camilli insists that the ineffectiveness of cooperative agreements arises due to the ability of the buyer to have the purchase delivered to a friend outside the jurisdiction of the cooperative agreement, who would then give the goods to the buyer.¹⁰⁷

¶41 Unfortunately, Camilli’s argument overlooks the central flaw of cooperative systems: the onus placed on the states.¹⁰⁸ States are now required to transfer tax information to each other instead of businesses. This may not seem onerous when only two or three states institute a program, but for a cooperative agreement to be completely effective, more and more states will have to implement similar programs. In the end, if a state wishes to realize all of the revenue that could be collected through an Internet sales tax system, it would have to engage in cooperative agreements with forty-nine separate states.

¶42 This is a ludicrous solution, as the same results could be achieved by having the businesses collect and submit the tax directly to the state. Several companies already accomplish this task. For example, Wal-Mart “argues sales taxes are not that difficult to collect; they are not the monster that some people think they are; and all Internet businesses should be taxed equally.”¹⁰⁹ Office-supply company Franklin Covey also voluntarily complies, “filing returns in every state that has a sales tax and a use tax.”¹¹⁰ Even if companies object to having to comply with fifty separate state tax regimes, not to mention thousands more at the local levels,¹¹¹ this is an argument more for uniformity rather than against viability.¹¹²

¹⁰⁵ See *supra* notes 46-47 and accompanying discussion.

¹⁰⁶ Camilli, *supra* note 11 at 148.

¹⁰⁷ *Id.*

¹⁰⁸ Not only does Camilli fail to attack cooperative agreements at their weakest point, but his own conclusion leaves something to be desired. Having a purchase delivered to a friend seems like an extraneous step most reasonable people would want to avoid unless the purchase, and the subsequent sales tax, was for a substantial amount. This is not to say that such a situation would never be advantageous. For instance, if the buyer lived in Tinley Park, Illinois and the friend lived in Gary, Indiana, or if a group of friends lived in “four corners” (Utah, Colorado, Arizona and New Mexico respectively), it would be possible to avoid or lower sales taxes by sending the purchased item “through” state lines. Of course, the buyer then assumes a higher risk of never receiving the purchase.

¹⁰⁹ Val John Christensen, *Leveling the Playing Field: A Business Perspective on Taxing E-Commerce*, 2000 BYU L. REV. 139, 141 (2000).

¹¹⁰ *Id.* Franklin Covey does so somewhat reluctantly, however, noting that it must “generate over three-and-a-half million dollars in sales revenue in 1999 just to finance the cost of its sales tax compliance activities.” *Id.* Such resentment stems from the fact that there is little to no similarity among different states’ use tax procedures, which increases costs tremendously. See *id.* at 153 (“We would love to see simplification. We would love to see one rate per state . . . We would like to see in this whole process the balance of sovereignty of states and the push for a uniform simplified taxing mechanism.”).

¹¹¹ “In the United States alone, there are nearly 30,000 state and local taxing jurisdictions, each with a viable claim to a slice of the Internet pie.” Fallaw, *supra* note 93, at 163.

¹¹² The subject of uniformity is beyond the scope of this paper, but has been discussed as a possible solution to the burdens of sales tax collection. See Aaron G. Murphy, Comment, *Will Surfing the Web Subject One to Transient Tax Jurisdiction? Why We Need a Uniform Federal Sales Tax on Internet Commerce*, 22 SEATTLE UNIV. L.R. 1187 (1999).

¶43 The standardization argument, “[that] lack of uniformity among the numerous state and local taxing jurisdictions . . . [imposes] a potentially enormous burden on interstate commerce,” obscures the real issue.¹¹³ Homogeneity is simply an implementation argument and does not affect the validity of the basic idea.¹¹⁴ Businesses owe taxes. That principle “indicates a belief that goods or services provided by means of electronic commerce should not be taxed any differently than goods or services procured through more conventional forms of commerce.”¹¹⁵ Giving one sector of the economy special privileges, while subjecting traditional brick-and-mortar operations to the complexities of the taxing system, violates the basic tenet of tax neutrality. When tax neutrality occurs, tax rules do not affect the purchasing habits of individuals or the retail strategies of business.¹¹⁶ Regardless of whether consumers choose to purchase items over the Internet for other reasons, the federal government should allow the states to claim rightful revenues.

¶44 Finally, the politically motivated accusations which allege that taxing Internet sales leads to harassment, undue burdens, and failed companies just misdirect the issue.¹¹⁷ The controversy is revenue to which the states already have legal entitlement; again, the question is not one of validity, but one of procedure. Internet sales systems already collect the pertinent information required for sales taxes; companies require information such as name, location, telephone number, etc., because it assures payment from the consumer. Placing the responsibility on the consumer to pay these taxes resigns the government to negative revenue by requiring audit procedures whose costs outweigh the revenue benefits. Therefore, the economically sound procedure is to have businesses collect Internet sales taxes.

B. *The Statute: Short and Sweet*

¶45 Congress need not worry about struggling to create a statute giving states the power to collect online sales taxes. The Supreme Court practically gave step-by-step

¹¹³ Fallaw, *supra* note 42, at 165.

¹¹⁴ While solutions to implementation are beyond the scope of this paper, the idea of a “State Tax Information Clearinghouse” (STIC) provides one possible solution. *See* Camilli, *supra* note 11, at 160-62 (noting that “[a] STIC is appealing because it only requires vendors to report their information, which minimizes the administrative hassle of tracking thousands of tax rates”).

¹¹⁵ *Id.* at 164-65. *See also* Lundy, *supra* note 7, at 38 (“The states’ difficulty in imposing tax collection duties upon out-of-state vendors is a major obstacle to creating tax neutrality.”) *Cf.* SANFORD M. GUERIN & PHILLIP F. POSTLEWAITE, PROBLEMS AND MATERIALS IN FEDERAL INCOME TAXATION 8 (5th ed. 1998) (“In the past, tax policy theorists have concentrated primarily on whether the federal income tax is *equitable*: Does the income tax *treat* taxpayers with equal incomes *similarly* . . . and does it *differentiate appropriately* among taxpayers with unequal incomes . . . ?”) (emphasis added).

¹¹⁶ Kashi M. Way, Note, *State and Local Sales Tax on Internet Commerce: Developing a Neutral and Efficient Framework*, 19 VA. TAX REV. 115, 126 (1999).

¹¹⁷ Senator Leahy of Vermont points to the fact that thousands of multiple jurisdictions around the country could crush electronic commerce. “For example, the Vermont Teddy Bear Company . . . sells 60 percent of its bears online during its two busiest times of the year—Valentine’s Day and Mother’s Day. . . . How could anyone vote against bears as cute and cuddly as these?” Remarks of Senator Patrick Leahy On The Internet Tax Non-Discrimination Act of 2003, November 5, 2003, *at* <http://leahy.senate.gov/press/200311/110503.html> (last visited March 11, 2004). Senator Leahy’s comments illustrate a myopic view: no mention is made of the online companies that already comply with the taxing of multiple jurisdictions or the idea that the solution lies in conformity and reduced complexity between jurisdictions rather than a free ride for electronic commerce.

instructions on how to construct such legislation, and academic literature has already produced one such solution.

In the levying sales and use taxes, an entity, whether a person or business, must purposefully direct his/her activities within the taxing state and must avail him/herself of the benefits of the jurisdiction. These benefits include the provision of a market in which to conduct business, of police services, and of a tribunal in which to have the ability to state his/her claims. This Act shall hereby repudiate any requirement of physical presence within the taxing state.¹¹⁸

¶46 Such a statute wisely overturns *Quill's* physical presence requirement. In doing so, it brings Due Process analysis into harmony with Commerce Clause jurisprudence, leaves decision-making authority with the states, and falls in line with *Zippo*. Jurisdiction would be available to a state, regardless of the online business's physical and shipping locations, as long as the website was interactive.¹¹⁹ This would allow states to decide whether to tax Internet sales and allow Internet businesses to be involved in developing implementation systems.

C. *A Plastic Passion*

¶47 The United States is a nation of credit cards. Statistics illustrate that “at the end of 2001, Americans had more than 1 trillion credit-card accounts (more than three accounts for every man, woman, and child in the country), on which they were charging more than \$1.2 trillion worth of purchases a year.”¹²⁰ Credit card usage has engulfed the Internet as well. “The Pew survey, conducted in 2000, found that 48% of Internet users have bought something online with a credit card.”¹²¹ As “[o]nline transactions have grown substantially over the past few years, with 4.9 million credit card transactions in 1997, 9.3 million in 1998, and 19.2 million through the third quarter of 1999.”¹²²

¶48 Credit card data provides a solution for companies wanting to know what sales tax rate to apply to a consumer's purchase. By using the data such a payment system provides, i.e., the customer's billing address, companies will be able to garner more than enough information to apply local sales tax rates. Though not all-encompassing, this solution indicates a promising beginning.

¹¹⁸ Groves, *supra* note 46, at 312; Groves, *supra* note 8, at 633-34 (“To accept the challenge by the Supreme Court to establish a more practical standard by which courts may exercise Commerce Clause scrutiny, Congress need only enact a law resembling the following . . .”).

¹¹⁹ *Supra* notes 80-82 and accompanying discussion. If instead, the website merely provided information and a telephone number with which to call and place an order, jurisdiction would be denied. *Id.* This idea is rather important in that it harmonizes *Quill* and *Zippo* and does not require the Supreme Court to resolve a perceived conflict.

¹²⁰ LYNN M. LOPUCKI ET AL., COMMERCIAL TRANSACTIONS: A SYSTEMS APPROACH 403 (2d ed. 2003).

¹²¹ Hahn & Layne-Farrar, *supra* note 6, at 210.

¹²² *Id.* at 209-10.

D. Wherever You Go, There You Are

¶49 Of course, not all consumers choose to use plastic when making online purchases. “[A]s other forms of ‘electronic cash’ develop, the purchaser’s residence may become more difficult to trace.”¹²³ Although this may appear to cause a problem, solutions are available without the information provided by credit card companies. Apple, for instance, provides the following explanation on its website:

Apple Store purchases will include sales tax based on the *ship-to location* and the sales tax rate in effect at the time of shipping. . . . If the sales tax rate for the state to which your order is being shipped changes before the product is shipped, the new tax rate in effect at the time of shipment will apply.¹²⁴

¶50 Further proof that Apple does not need credit card data is illustrated by the fact that payment methods include cashier’s checks, money orders, and wire transfers, as well as ever-popular credit cards.¹²⁵ Even without credit cards, the potential still exists to collect the data needed to apply a sales tax; such information can be provided through buyers’ shipping addresses. This solution is not without problems, but there is no perfect system free of difficulties such as rogue consumers who lie about their address. Nonetheless, once Internet sales taxes are allowed, only creativity will restrict the solutions already being explored by Apple and other companies.

V. CONCLUSION

¶51 In the United States, accessing the Internet is no less common (AU: I rejected a change here to “just somewhat,” because I think that undercuts the strength of the sentence. While the sentence obviously is not 100% accurate, I feel an average reader would be able to recognize the distinction.) than driving to work; millions of people engage in the activity on a daily basis.¹²⁶ Unsurprisingly, then, legal control of the Internet’s boundaries often raises fears that innovation will be stifled. Sometimes these worries have merit. The idea that greater regulation of the Internet could stifle its development is legitimate. Often, however, these worries are based on irrational suspicions and assumptions.

¶52 States lose revenue each day that Internet sales receive tax-immunity. While several online retailers have voluntarily begun collecting state sales tax, neither Congress nor the courts can rely on such methods. “However attractive the notion of a voluntary system of taxation, the idea invariably falls short when it comes to actually separating

¹²³ Kashi, *supra* note 116, at 129.

¹²⁴ Apple Stores, Sales and Refund Policy, *available at* www.store.apple.com/Catalog/US/Images/salespolicies.html (last visited Mar. 11, 2004). Such a solution also answers the conundrum of how to tax a consumer with a billing address and a shipping address that are not identical.

¹²⁵ *Id.*

¹²⁶ Fallaw, *supra* note 41 at 162 (“An estimated 66 million Internet users were located in the United States alone in 1998.”). *See also* Camilli, *supra* note 11 at 153 (“Internet use has grown from about 5 million users in 1993 to 62 million in 1997, and it is expected to reach 550 million by the year 2000.”).

individuals from their wealth.”¹²⁷ While the Supreme Court has passed the buck on the issue, Congress has turned a blind eye. Still, the promise of such a system rests in the hands of the Legislators. The arguments for implementation are sound. The Internet continues to grow, sales continue to increase, and consequently Congress must implement the solution now or risk repairing havoc later.

¹²⁷ GUERIN & POSTLEWAITE, *supra* note 115, at 1.