

CEI ON POINT

The Competitive Enterprise Institute

1001 Connecticut Avenue NW • Suite 1250 • Washington, D.C. 20036 • (202) 331-1010 • <http://www.cei.org>

Committed to Advancing the Principles of Free Enterprise and Limited Government

May 12, 2000

No. 64

Internet Taxation: Why Wyden Won't Wash

by Michael S. Greve*

After only three weeks of what apparently passes for congressional deliberation these days, the Internet tax moratorium (currently set to expire in October 2001) has become a political football. Before lasting damage is done and spectators slink off in disgust, someone should call a time-out.

E-commerce friends gained a victory on Wednesday when the House voted 352-75 to extend for another five years the moratorium on taxing remote Internet sales. That same House, however, then voted for an amendment introduced by Rep. Ernest J. Istook (R-OK) supporting the streamlining and simplification of state and local sales taxes. The Istook Amendment effectively ratifies the agenda of the "Big Seven" state and local government lobbies: Simplify sales taxes to appease the corporations that collect them; then, tax Internet sellers (along with everyone else).

While the Istook Amendment is only a "sense of the Congress" resolution, the next shoe has already dropped. Senator Ron Wyden (D-OR) is circulating a bill that would obligate Congress to vote, in five years, on giving states and localities new tax-collection powers. States would have until the end of the proposed five-year moratorium extension to "simplify" and "harmonize" their tax system in order to qualify for these new taxing privileges.

The Political Dynamics Are Foreboding. Legislators view the Internet sales tax moratorium as a subsidy for e-commerce—in large measure because both sides in the debate have so described the moratorium. State and local governments, as well as bricks-and-mortar retail lobbies, have attacked the moratorium as a selective e-commerce subsidy. E-commerce friends have *defended* the moratorium as a subsidy—albeit a good one, since the Internet is a sexy but (supposedly) vulnerable "infant industry." Voting "against the Net" is like voting against widows and orphans, with the further complication that the e-commerce infant coughs up campaign contributions. Leaders of both parties have effectively acknowledged, and everyone within shouting distance of the e-tax debate understands, that the House moratorium vote was part of a shameless bidding war for campaign cash.

* Michael S. Greve (mgreve@cei.org) is an adjunct scholar at the Competitive Enterprise Institute and a resident scholar at the American Enterprise Institute.

The notion that the congressional leadership of both parties will, in an election year, simply roll over their state and local leaders is absurd. Since powerful state and local government lobbies view an extended Internet sales tax “exemption” as utterly, absolutely unacceptable, it is highly unlikely that a “clean” moratorium—that is, a moratorium that affirmatively forecloses an extension of state and local sales tax authority—will emerge from this Congress.

Sensible Solutions to the E-commerce Sales Tax Conundrum Do Exist. A particularly compelling approach is to permit interstate sales (through the Internet or any other channel) to be taxed only at their point of origin, rather than (as now) on the basis of their destination. Such an origin-based regime would greatly simplify the existing sales tax system. It would treat all sellers and sales channels alike, thus ending concerns over tax discrimination against Main Street retailers. And it would permit states and localities to tax sales from their own jurisdictions to their hearts’ content—at the salutary risk that high-tax jurisdictions may find their businesses moving elsewhere. Instead of governmental exports of tax collection obligations, we would have robust tax competition—and taxation with representation.

Such proposals, however, cannot even be considered so long as Congress sacrifices deliberation to a mad rush for campaign cash and election support from the governors’ and mayors’ political machines. The mayhem on the Hill threatens to produce an Internet that is either taxed or hopelessly politicized, or possibly both. To the extent that e-commerce winds up with a sales tax exemption, that result will be viewed as a special interest deal. The same politicians who are now coddling the Internet infant will feel entitled to slap it around once it has grown into a pre-teen.

The Right Way, or the Highway. It may yet prove possible to mobilize support for a squeaky-clean moratorium extension to buy more time for comprehensive sales tax reform that precludes cross-border tax grabs. A Wyden-esque moratorium, in contrast, would put us on a path to the governors’ sales-tax cartel. If that sort of “compromise” becomes the only game in town, responsible legislators should walk away now—and try again after the elections.