

# The Need for Implementation of a Tax at Source and Transfer Sales Tax Model to Overcome the Impacts of Internet Sales on the US Economy

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The opinions and views expressed in this paper are those of the authors and are not official views of the Australian Taxation Office nor the OECD.

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## Executive Summary

The existing sales and use tax system is promoting unfair competition as untaxed Internet facilitated sales to consumers take market share from locally owned, taxpaying and employing traditional businesses. This is also resulting in the erosion of the existing sales taxation base and is widening the digital divide.

Electronic commerce should be seen as a business tool, not as the key to a market which permits avoidance of the states' sales tax systems. Rather than subsidising these Internet sales, the taxation system should promote neutrality and equality between traditional and electronic sales.

To achieve this neutrality and equality, we advocate the introduction of a *tax at source and transfer* taxation system. Not only is this model the most effective, it also imposes the least compliance burden on both business and consumers, while providing the least administrative burden for governments. It would also provide a basis for future moves to a more even taxation platform by the states and local governments.

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## Introduction ...

We have been following the Commission's debate on electronic commerce with great interest. Obviously the decisions and approaches adopted within the United States for the taxation of cross border Internet sales will significantly impact on the mechanisms used by other countries.

We would like to provide some additional comments and insights around the issue of the taxation of electronic commerce. We emphasise that these views have been put forward in a personal capacity and are not necessarily those of the Australian Taxation Office nor the OECD.

At the San Francisco Meeting on 15 December 1999, Richard Parsons raised the issue of whether 'there is something about electronic commerce that warrants treating it differently ... than sales effected in some non-electronic way?'<sup>1</sup>

In our opinion, the short answer is no, there is and should be no difference in treatment. Electronic commerce is primarily a distribution method which is permitting business to achieve market penetration and efficiency gains in the way they conduct their operations that have not previously been possible. This view on the neutrality of taxation systems is shared with OECD members, including the US, who expressed this principle as:

"Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. ... Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation."<sup>2</sup>

Historical factors have resulted in taxation advantages being realised by businesses making remote sales across state borders. The growth of telephone and mail order operations is one sign of the exploitation of the *Quill*<sup>3</sup> decision. We believe that a growing part of the business-to-consumer growth in Internet sales is based upon the price advantage this taxation concession confers on remote sales<sup>4</sup>. While insignificant in the current context, this will give rise to three major impacts which we believe will be of an unacceptable magnitude within the next five years:

1. Unfair competition as untaxed Internet facilitated sales to consumers take market share from local taxpaying and employing businesses.
2. Erosion of the existing sales and use tax base by an exponentially increasing annual amount.
3. Further growth in the digital divide leading to social and economic disadvantages for those who can not afford computer and Internet access.

For these reasons, we believe it is important for both equity and economic efficiency reasons for taxation systems to move quickly towards neutrality between traditional retail sales and e-tail sales. We therefore recommend the adoption of a 'tax at source and

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<sup>1</sup> Page 409, Transcript of December 15 1999, Third Meeting, Advisory Commission on Electronic Commerce.

<sup>2</sup> OECD, "Electronic Commerce: Taxation Framework Conditions. A Report by the Committee on Fiscal Affairs", DAF/FE/CFA(98)38/REV3, 27 July 1998, page 5, available at [http://www.oecd.org/daf/fa/e\\_com/frameworkke.pdf](http://www.oecd.org/daf/fa/e_com/frameworkke.pdf).

<sup>3</sup> *Quill v North Dakota* 504 US 298 (1992)

<sup>4</sup> For example, Goolsbee has suggested that this is a motivation for 25 - 30% of online spending (Goolsbee, Austan, 'In a world without borders: the impact of taxes on Internet commerce, November 1998, page 5).

transfer' model for imposing consumption (sales and use) taxes on cross border e-commerce transactions. This model is expanded upon later in this paper.

## **Why the existing taxation system will not work in the Internet age**

### **Unfair competition from untaxed Internet facilitated sales**

The incredible growth in electronic commerce has been accompanied by the creation of a small number of brands which have become global leaders in the marketing and distribution of their products via the Internet.

The world's most popular e-tailer is Amazon.com. While largely associated with its beginnings as a pure online bookseller, its success and business model have expanded considerably. The market leadership and consumer acceptance of Amazon.com is also evident in other market segments by e-tailers such as CDnow (for music) and eBay (for auctions).

What is now becoming evident is that these Internet companies are using their high market values to eliminate their competitors and to take over other companies with high market shares. For example, Ernst and Young report that Amazon has now purchased or owns an interest in 20 other businesses encompassing auctions; retail; technology and information (see Attachment 1). The January 2000 announcements of the mergers of America Online, Time Warner and EMI is another example. During 1999, eBay acquired Butterfield & Butterfield (the 134 year old San Francisco auction house) and Kruse International (the upscale car auctioneer). Similar alliances and acquisitions have also been identified by the OECD as prevalent in international markets<sup>5</sup>.

Only 10% of respondents to a survey of e-tailers by Ernst and Young indicated that acquisition of other businesses was part of their growth strategy<sup>6</sup>. However if this 10% is the top end of the market, backed with the enormous buying power their share prices give them, their size will continue to grow as they work towards reducing competition and competitors in their chosen markets.

Of even more concern for traditional retailers is the research by Jupiter Communications indicating that the growth in Internet commerce will be at the expense of traditional sales<sup>7</sup>. Jupiter found that only 6.0% of business-to-consumer Internet sales in 1999 were incremental sales with this figure increasing to 6.5% for Internet sales in 2002. This indicates that 94% of Internet sales are sales that traditional retailers would have expected to make. While some proportion of these sales would be facilitated by the Internet operations of traditional retailers, the fact remains that most of the sales of the pure Internet e-tailers are sales poached from traditional retailers.

The continuation of the preferential taxation treatment of e-commerce will continue to exacerbate the sales losses of traditional businesses as the e-tailers exploit their unfair advantage. It can be expected that this may result in the forced closure of many traditional businesses offering services to local and remote communities. How will the local bookstore compete against the purchasing power of companies such as Amazon.com and Barnes and Noble when this is also backed by a tax advantaged position for their Internet sales?

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<sup>5</sup> OECD, 'The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda', 24 August 1998, DSTI/ICCP(98)15/PART5, page 12, available at [www.oecd.org/subject/e-commerce/summary.htm](http://www.oecd.org/subject/e-commerce/summary.htm).

<sup>6</sup> Ernst & Young, 'Global Online Retailing', January 2000, page 47.

<sup>7</sup> Jupiter Communications press release, 'Digital Commerce Growth Will Be at Expense of Off-line Dollars', 4 August 1999. Available at [www.jupitercommunications.com/company/pressrelease.jsp?doc=pr990804](http://www.jupitercommunications.com/company/pressrelease.jsp?doc=pr990804)

### Erosion of the existing sales and use tax base

At the current point in time, the quantum of Internet enabled business-to-consumer sales is relatively small in relation to total consumer sales. In addition, some sales that are economically equivalent to Internet facilitated sales are also sales tax free. As a result, the current levels of erosion of the existing sales and use tax base are fairly insignificant.

In this regard, we tend to agree with the conclusions of Cline and Neubig on current erosion levels in their study for the eCommerce Coalition<sup>8</sup>. Their study was based on state sales tax collections which traditionally comprise 82.5% of total state and local sales tax collections according to US Bureau of Census figures<sup>9</sup>.

However once their analysis is extrapolated forward to 2003 and beyond, quite a different and less sanguine result is produced. The Organisation for Economic Development (OECD) has published the following estimates of global electronic sales<sup>10</sup>:

Table 1: OECD Projections of E-commerce sales

Timeframe	E-commerce value in \$US billions	E-commerce as % US credit card purchases	E-commerce as % direct marketing	E-commerce as % OECD total retail sales
Current – 1996/97	26	3%	2%	0.5%
Near term – 2001/2	330	24%	18%	5%
Future – 2003/5	1,000	54%	42%	15%

The \$1 000 billion estimate for e-commerce sales in 2003/5 is already looking very conservative when compared to more recent studies. For example, Forrester Research's press release of 17 December 1998 predicted that "US business trade on the Internet will explode from \$43 billion in 1998 to \$1.3 trillion in 2003". They also predict "on-line business trade to surpass 9% of total U.S. business sales by 2003"<sup>11</sup>.

On 20 January 2000, ActivMedia Research went even further in announcing their latest online research data which indicates that "the total dollar amount spent online in business-to-consumer (B-to-C) retail purchases will grow to over \$2 Trillion by 2005"<sup>12</sup>.

On the basis of this information, we can conservatively accept that the OECD prediction of \$1 000 billion in e-commerce sales is likely to be achieved by 2003 at the latest. The OECD notes that the US share of e-commerce sales is likely to fall over this period from its current level of 80% of e-commerce sales to 75% as European sales increase. If we

<sup>8</sup> Cline, Robert J and Neubig, Thomas, S, 'The sky is not falling: why state and local revenues were not significantly impacted by the Internet in 1998', Ernst & Young, June 18 1999

<sup>9</sup> Available at [www.census.gov](http://www.census.gov)

<sup>10</sup> The OECD paper: "The Economic and Social impact of Electronic Commerce: preliminary findings and research agenda" is available at [http://www.oecd.org/subject/e\\_commerce/summary.htm](http://www.oecd.org/subject/e_commerce/summary.htm).

<sup>11</sup> See [www.forrester.com](http://www.forrester.com)

<sup>12</sup> See [www.ActivMediaResearch.com](http://www.ActivMediaResearch.com)

accept the general figure of 80% of e-commerce sales being business-to-business, we can estimate the total US business-to-consumer e-commerce sales in 2003 to be \$150 billion (\$1 000 billion x 75% x 20%).

While we believe the methodology of Cline and Neubig to be very conservative in estimating the extent of sales tax losses, if we accept their methodology we can extend their Table 3<sup>13</sup> to estimate the sales tax loss for 2003 and beyond<sup>14</sup> if the current taxation regime is maintained:

**Table 2: Estimated Sales Tax Losses from 1998 to 2007**

Steps	Percent of Sales	1998 Amount (Millions)	2003 Amount (Millions)	2005 Amount (Millions)	2007 Amount (Millions)
Total Business-to-Consumer Sales	100	20 000	150 000	400 000	1 090 000
Less: Percent Non-Taxable	63	12 600	94 500	252 000	686 700
Equals: Taxable Sales	37	7 400	55 500	148 000	403 300
Less: Sales Tax Paid	4	-800	-6 000	-16 000	-43 600
Less: Sales Substituting for Other Remote Sales, No Tax Collected	20	-4 000	-30 000	-80 000	-218 000
Equals: Sales, No Tax Collected	13	2 600	29 500	52 000	141 700
Times: Average State and Local Tax Rates <sup>15</sup>		6.97%	6.97%	6.97%	6.97%
<b>Equals: Estimated Sales Tax Loss</b>		<b>\$181</b>	<b>\$2 056</b>	<b>\$3 624</b>	<b>\$9 876</b>

If combined State and Local sales tax collections continue to grow at an average compound growth rate of 5.7% pa (which is unlikely given the impact of e-commerce sales) total collections in 2003 would be in the order of \$206 billion. The sales tax loss of \$2.1 billion is already nearly 1%, more than a tenfold increase since 1998.

Continuing these series forward to 2005, we see that of a potential sales tax collection of \$237 billion, a loss of \$3.6 billion represents 1.5%. By 2007, we are looking at a loss of \$9.9 billion out of a potential sales tax collection of \$265 billion, or 3.7%.

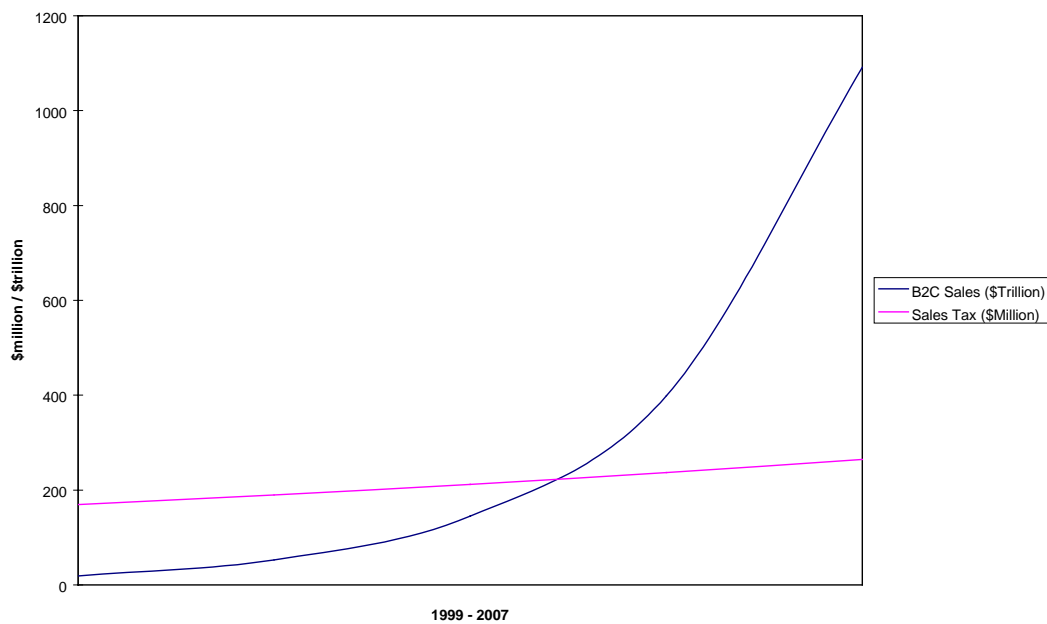
This pattern is clearly evident in the graph below which shows sales tax collections and business-to-consumer Internet sales over the period 1999 to 2007. The actual pattern is even more marked as the business-to-consumer sales in the graph are shown at 1000<sup>th</sup> of their relative size to the sales tax collections. The difference in growth levels is apparent with sales tax collections failing to match business-to-consumer Internet sales.

<sup>13</sup> Cline, Robert J and Neubig, Thomas, S, 'The sky is not falling: why state and local revenues were not significantly impacted by the Internet in 1998', Ernst & Young, June 18 1999, page 10.

<sup>14</sup> This analysis assumes that the current exponential growth in Internet business-to-consumer sales continues through to 2007. We do not expect this exponential growth to cease until this market and its sales reach maturity at around 15% of total worldwide sales between 2015 and 2020.

<sup>15</sup> Cline and Neubig based their calculations on an average state tax rate of 6.5%. We have preferred to use a population weighted average of state and local sales tax rates of 6.97%. Using an average tax rate of 6.5%, the estimated sales tax loss per annum would be 2003 (\$1 918 or 1%); 2005 (\$3 380 or 1.4%); and 2007 (\$9 210 or 3.5%).

Graph 1: Forecast of sales tax collections and business-to-consumer Internet sales



The actual impact of the Internet on sales tax revenues is likely to be much higher than indicated by these figures. We are already seeing the substitution of currently taxable products into untaxed digitized forms. Music, books, software, movies and other digital infotainment products are the main categories at present. The OECD's research has identified substitution in various industries as shown in Table 3:

Table 3: Shifting from physical to electronic markets: changes in the business model<sup>16</sup>

Sectors	Degree of business substitution
Music	radical
Publishing	radical
Transport	partial
Information services	mixed evidence
Retail banking	radical
Marketing and advertising	none

The rapid improvements in compression software and in bandwidth for Internet access will make the distribution of these digitized products even more commercially viable in the next few years. The actions of content owners such as Time Warner and EMI in merging with the distribution assets of AOL, and of Blockbuster in moving into electronic distribution, are early signs of this substitution occurring.

### Further growth in the digital divide

Ernst & Young's survey leading to their Third Annual Online Retailing Report asked respondents why they shopped on line<sup>17</sup>. While the convenience factor was important,

<sup>16</sup> OECD, 'The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda. Executive Summary', DSTI/ICCP(98)15/PART5, 19 August 1998, Annex Table 5.1, page 23, available at [www.oecd.org/subject/e-commerce/summary.htm](http://www.oecd.org/subject/e-commerce/summary.htm)

<sup>17</sup> As reported by CyberAtlas, 'Online Holiday Shoppers to Triple' 9 November 1999, available at [www.cyberatlas.internet.com](http://www.cyberatlas.internet.com)

'because items cost less' was the response from 16% of those surveyed while 12% noted that it was because they didn't incur sales tax. Both responses indicate that consumers are price sensitive on the products they purchase online. Similar findings have been reported by Goolsbee<sup>18</sup>.

However these price benefits that online purchases are facilitating are not available to all. After analysing several surveys across a number of countries, the OECD concluded that:

*One consistent finding across many countries is that there is a strong positive correlation between the use of information technology (PC ownership, access to the Internet) and household income: for every \$10 000 increase in household income, the percentage of homes owing a computer increases by seven points.*<sup>19</sup>

The latest US demographic figures from Ernst and Young<sup>20</sup> indicate that while 53% of households have PCs, only 34% are online and only 17% have shopped online. These online buyers have a weighted average annual income of \$59 000. Clearly, online shopping is not available to all. This situation is unlikely to change while many families can not afford computers.

Ted Waitt noted at the San Francisco meeting that Gateway had declined credit for 184 000 families in October 1999 and 250 000 families in November 1999. These families were trying to buy computers "so their children don't fall behind, and so they can get their kids on the Internet. Now, they don't have credit cards, so they're not going to be large E-commerce purchasers, and if we're giving the Internet just an exemption in terms of collecting sales tax, we do run the risk of widening that gap"<sup>21</sup>.

So we have a societal inequity where higher income earners are able to benefit from buying goods cheaper online through a distribution network not available to many lower income families. We find it hard to justify why this inequity should be further subsidised by the non-application of sales and use taxes to Internet sales.

It is also enlightening in this regard to look at what consumers are buying online. In order of most popular Internet purchases, consumers are buying computers, books, CDs, electronics and toys. Given the demographics of online buyers as outlined above, these consumer items are not those that inherently need Government subsidisation.

### **Achieving parity between traditional retail sales and e-tail sales ...**

Usage of the Internet and the e-commerce it is facilitating is growing quickly amongst those in society who can afford access and have the purchasing power to enjoy the benefits it is providing.

To minimise the adverse effects of this growth on society, we believe the Commission should recommend the removal of the current inequity in treatment between the distribution method of goods and services purchased from traditional sources and those purchased over the Internet. The following comments are offered in relation to the policy

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<sup>18</sup> Goolsbee, Austan, 'In a world without borders: the impact of taxes on Internet commerce, November 1998, page 5

<sup>19</sup> OECD, 'The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda. Executive Summary', 19 August 1998, page 14, available at [www.oecd.org/subject/e-commerce/summary.htm](http://www.oecd.org/subject/e-commerce/summary.htm)

<sup>20</sup> Ernst & Young, 'Global Online Retailing', January 2000

<sup>21</sup> Page 444 & 445, Transcript of December 15 1999, Third Meeting, Advisory Commission on Electronic Commerce.



options outlined under IV. *The Application of Transaction Taxes to Sales Conducted Through the Internet* in the ACEC's *Issues and Policy Options Paper*.

### **A. Tax Treatment of Tangible Personal Property and Taxable Services**

We would like to suggest an alternative model for imposing sales and use taxes on Internet and other transactions subject to these taxes.

The model can be implemented independently of any changes made to the existing taxation schemes of the state and local governments. However any simplification of these systems along the lines advanced by policy options 5 and 6 would make the functioning of the overall taxation system much smoother.

However we note that political realities will mean that harmonisation of the multitude of sales and use taxation systems is a goal which is unlikely to be successful in the short term. We therefore propose a model which overcomes the difficulties in taxing cross border transactions, removing the undue burden otherwise imposed on interstate commerce by facing compliance with a number of sales and use taxation jurisdictions. While a medium term goal of simplifying the sales and use taxation system would be desirable from the point of view of both taxation administrations and business, it is not a precondition for implementing a coherent sales taxation regime for remote sales.

Our suggested model is attached as Attachment 2. The important features of the model can be summarised as follows:

#### ***Nature of purchaser***

- Sales taxes only apply to consumer sales so if purchaser provides proof (a digital certificate for example) of being a business, no tax is imposed.

#### ***Determine jurisdiction***

- Once we have established that it is a consumer transaction, we need to determine the jurisdiction which has taxing rights. If the consumer offers an digital certificate approved by their local taxation administration, the jurisdiction will be specified and the transaction can proceed on this basis. (Note that this provides an incentive for taxation administrations to work with digital certificate providers, further increasing their acceptance and use in all Internet transactions.) In the absence of a digital certificate, other tests will need to be invoked as follows.
- For purchases of goods, the jurisdiction can be determined from the delivery address.
- For services and other intangibles (such as electronically delivered products) the jurisdiction can be based on the consumer's Internet Protocol (IP) number. A simple traceroute query will identify the location of the consumer and is already used by businesses who are prohibited from trading certain items cross borders (eg. online casinos and sellers of software incorporating advanced cryptography features, anti-hacker bodies and law enforcement agencies)<sup>22</sup>.
- An IP number traceroute may not be successful if the consumer uses an anonymiser or is from a jurisdiction outside the parties to this system. In this case, a throwback rule

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<sup>22</sup> *Traceroute* enquiries are readily available through many sites on the Internet. Attachment 3 presents a visual *traceroute* enquiry on the ACEC homepage using Visual Route which also presents a visual map of the route between our ISP in Canberra and the ACEC in Richmond. This program is available for purchase from [www.visualroute.com](http://www.visualroute.com).

can be adopted which allows the transaction to be treated as a local transaction for tax purposes<sup>23</sup>.

### **Determine tax payable<sup>24</sup>**

- Most jurisdictions apply different rates to specific groups of products. In order to apply the appropriate tax rate, it will be necessary to classify the product. We would recommend using the existing United Nations Central Products Classification System (available at [www.un.org/depts/unsd/class/cpcprof.htm](http://www.un.org/depts/unsd/class/cpcprof.htm)). Businesses already need to classify their products for local sales, this would merely require the standardisation of classification across states. It would also provide an opportunity for state governments to simplify their sales tax systems as they apply to different product groups.
- Now we know the jurisdiction and the product, a database lookup can provide the appropriate tax rate to apply to the value of the sale. This database could be maintained by a central authority and made publicly available on a website so businesses would always have access to the correct information. This feature is already available in several commercially available packages. The maintenance costs of the database could be covered by a fee based on usage.
- Once the seller has calculated and retained the tax payable on the transaction, the tax can be remitted to their local tax authority in the normal manner and accompanied by jurisdictional information. The local tax authority can then remit amounts to other jurisdictions on a periodic basis after deduction of an appropriate small percentage to cover their collection costs.

This system offers a number of benefits to all those involved. For example:

- Businesses only have to deal with their local tax administration and do not have to deal with authorities from other jurisdictions. They do not need to lodge records with other revenue authorities for sales made to consumers in other states.
- Local authorities have an incentive to ensure compliance with the law in the seller's jurisdiction. They also do not have to work to establish clearinghouses for revenue distribution as advocated by other models, avoiding the fees and expenses that would be involved in working through clearinghouses. The model is also delivery system neutral reducing administrative costs as it could be implemented for all cross border trade.
- In the consumer's jurisdiction, local authorities receive revenue for taxes that have been imposed to fund Government services for their constituents such as law enforcement, education, roads, hospitals and the welfare system.

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<sup>23</sup> A throwback rule has been criticised by some who claim that it provides an incentive for businesses to claim that they can not determine the location of consumers who come from higher tax jurisdictions. This would enable them to supply the product at the lower rate of the business' local jurisdiction. It is suggested that this risk is very small. The potential savings for consumers are fairly small compared to the risk of the business being subject to penalties in their local jurisdiction. An algorithm check could be used by local tax authorities to provide a simple compliance test to ensure this practice does not become prevalent.

<sup>24</sup> Some commentators have suggested that the current US sales and use tax system is too complex to be modelled even with current computer and Internet capacity. This is easily disproved as these aspects of this model are already available in existing commercial products which offer sales / use tax calculations for the approximately 7 600 jurisdictions in the US. For example Taxware International Inc's SALES/USE Tax System 'completes the tax calculations while taking into consideration all tax jurisdictional issues, exemption processing, product processing, special or standard rates based on taxing location of city, state, ZIP code and county, as well as any maximum rates'. (See [www.taxware.com/Zproducts/salesuse/sutaxsys.htm](http://www.taxware.com/Zproducts/salesuse/sutaxsys.htm)). Taxware's products are already incorporated in a number of third party ecommerce systems including IBM's *Net.Commerce*. The jurisdictional verification features of our model constitute the main difference to the products already offered by Taxware.

- While the consumer pays a sales tax that they could currently avoid, their local economies will benefit from the additional tax revenue and resultant increases in local sales.
- The expansion of this model into the international arena also provides governments with a very strong incentive to adequately police pirated digital products in the country of the consumer. This incentive is created by the tax revenue they will receive from the revenue authority of the country of the business. This revenue will be based on the business' legitimate sales in the country of the consumer.

## B. Taxation of Digitized Goods

Consistent with our overall argument for subjecting all goods to the same taxation regime independent of their means of distribution, we would recommend that digitized goods should also be subject to the same taxation as their non-digitized counterparts. For this reason, we would recommend endorsement of Policy Option 1. This would leave taxation of digitized goods in the hands of the states and local governments along with other goods.

We see the primary issue to be the identification of those digitized goods which have been supplied over the Internet. The difficulty these goods pose for a taxation administration is in identifying the supply and the parties involved. The same issues also give rise to consumer protection concerns as consumers can have difficulty in identifying the business they are dealing with.

We would suggest that the states and local governments can assist by encouraging and requiring businesses to include 'real world' contact details on their web sites. For example, Consumers International reported the following levels of contact information provided on websites<sup>25</sup>:

Table 4: Contact Information Provided on Commercial Websites

Sites based in	Address	Registration	Phone	E-mail
	%	%	%	%
USA	73	7	74	86
<b>Average of 14 countries surveyed</b>	<b>72</b>	<b>12</b>	<b>74</b>	<b>83</b>

It can be seen from the above figures that the use of registration numbers on websites is quite low. However this information would greatly assist consumer confidence in dealing with e-commerce businesses.

There may also be a role for the states and local governments in encouraging the use of high integrity digital certificates amongst both businesses and consumers. Digital certificates would assist in identifying the owners of websites and the jurisdiction of consumers purchasing on the Internet. For example, the Australian Taxation Office has been working with a trusted digital certificate supplier to issue digital certificates to all businesses applying for the Australian Business Number. Not only will this assist the taxation administrator, it will also better facilitate business-to-business Internet trade as both parties to a proposed trade can be confident in the identity of the other party.

<sup>25</sup> Consumers International, 'Consumers@shopping: an international comparative study on electronic commerce', September 1999

### C. Nexus Concerns

Our recommendations logically give rise to a nexus solution which doesn't directly accord with any of the three Policy Options currently identified. There seems little doubt that a need exists for Congress to overcome the barriers to interstate taxation imposed by the US Supreme Court's decision in *Quill v North Dakota*.

The Supreme Court's conclusion that the more than 7 600 different tax jurisdictions was unfairly burdensome on interstate merchants was true in 1992 when they made their judgment. However the growth in computing power and the Internet in the intervening years gives rise to possibilities for reducing this burden which should now be grasped.

The model we have outlined above would permit the movement of the existing sales and use taxation systems towards an even application to all products independent of their method of distribution to the final consumer. Of course maintaining the existing differences between jurisdictions would be less than desirable. We believe that this move towards a more even taxation platform for all products will give the states and local governments an impetus to rationalise their sales and use taxation systems, leading to a more coherent and standardised methodology. In this regard, we would support the proposal of the National Governor's Association to move towards the implementation of a 'Streamlined Sales Tax System for the 21<sup>st</sup> Century'<sup>26</sup>.

### Concluding Remarks

We believe that a taxation system that achieves neutrality between traditional and electronic sales should be given a high priority for early implementation for the reasons outlined above. In reality, there are four main options available to governments to achieve this. These are:

- a **self assessment** system where customers calculate the tax owing on goods, services and intangibles acquired from interstate suppliers and remit the sales tax payable to their local tax authority;
- a **registration of non-residents** system which would require all businesses who conduct trade within a jurisdiction to register in that jurisdiction;
- a **tax at source and transfer** system where businesses collect taxes on supplies made to interstate customers and remit all taxes collected to their local tax authority who transfers any taxes on interstate trade to the tax authority of the customers' jurisdiction; and
- a clearinghouse system of **withholding by financial institutions** where financial intermediaries (such as banks and credit card companies) collect taxes from payments made from the customer to the business and remit these amounts to the tax authority of the customers' jurisdiction.

The following table compares the main attributes of the four taxation options<sup>27</sup>:

<sup>26</sup> See the NGA's paper at [www.nga.org/Internet/Proposal.asp](http://www.nga.org/Internet/Proposal.asp).

<sup>27</sup> Collection options are discussed in more depth in the Australian Taxation Offices 'Tax and the Internet, Second Report', December 1999 at pages 148 - 155. This report is available in both PDF and rtf formats at [www.ato.gov.au/content.asp?doc=/content/Businesses/ecommerce\\_Tati2.htm](http://www.ato.gov.au/content.asp?doc=/content/Businesses/ecommerce_Tati2.htm)

Table 5: Analysis of the Four Taxation Options

<b>Tax Collection Option</b>	<b>Feasibility</b>	<b>Effectiveness</b>	<b>Compliance Burden</b>	<b>Administrative Burden</b>
Self Assessment	Yes.	Least effective for business-to-consumer collections.	Small.	Substantial as requires substantial communication and aggressive enforcement. Effective enforcement would breach privacy.
Registration of Non-residents	Yes but difficulties identifying consumer.	Limited as difficult to enforce in external jurisdictions.	Significant compliance costs.	Burdensome and poses significant challenges.
Tax at Source and Transfer	Yes, requires agreement amongst states and local governments.	Good as only have to deal with revenue authority in business' home jurisdiction.	Very small additional burden. One set of books.	Small additional costs. No primary concerns.
Withholding by Financial Institutions	Doubtful as requires entirely new approach to collections.	High for credit card transactions, limited effectiveness for electronic cash.	Start up and ongoing costs likely to be significant. Mechanism for compliance enforcement undetermined.	After costs of establishing entirely new system, ongoing costs could be lower than traditional systems..

While all four options are potentially feasible, the tax at source and transfer option as modelled in this paper is not only the most effective, it also imposes the least compliance burden on both business and consumers, while providing the least compliance burden for taxation administrators.

For these reasons, we recommend this approach to the Commission and trust that our comments are of value as you prepare for your final deliberations in Dallas.

## Attachment 1

### Businesses which Amazon.com has purchased or owns an interest in<sup>28</sup>:

#### Auctions:

- Sotheby's auctions
- LiveBid.com live auctions

#### Retail:

- Drugstore.com
- Pets.com
- Ashford.com
- Exchange.com
- HomeGrocer.com
- Gear.com
- ZShops.com
- Video Game store
- Home Improvement store
- Gift Ideas store
- Tool Crib of the North

#### Technology:

- Alexa Internet Web navigation technology
- Geoworks cell phones
- Accept.com —commerce transactions

#### Information:

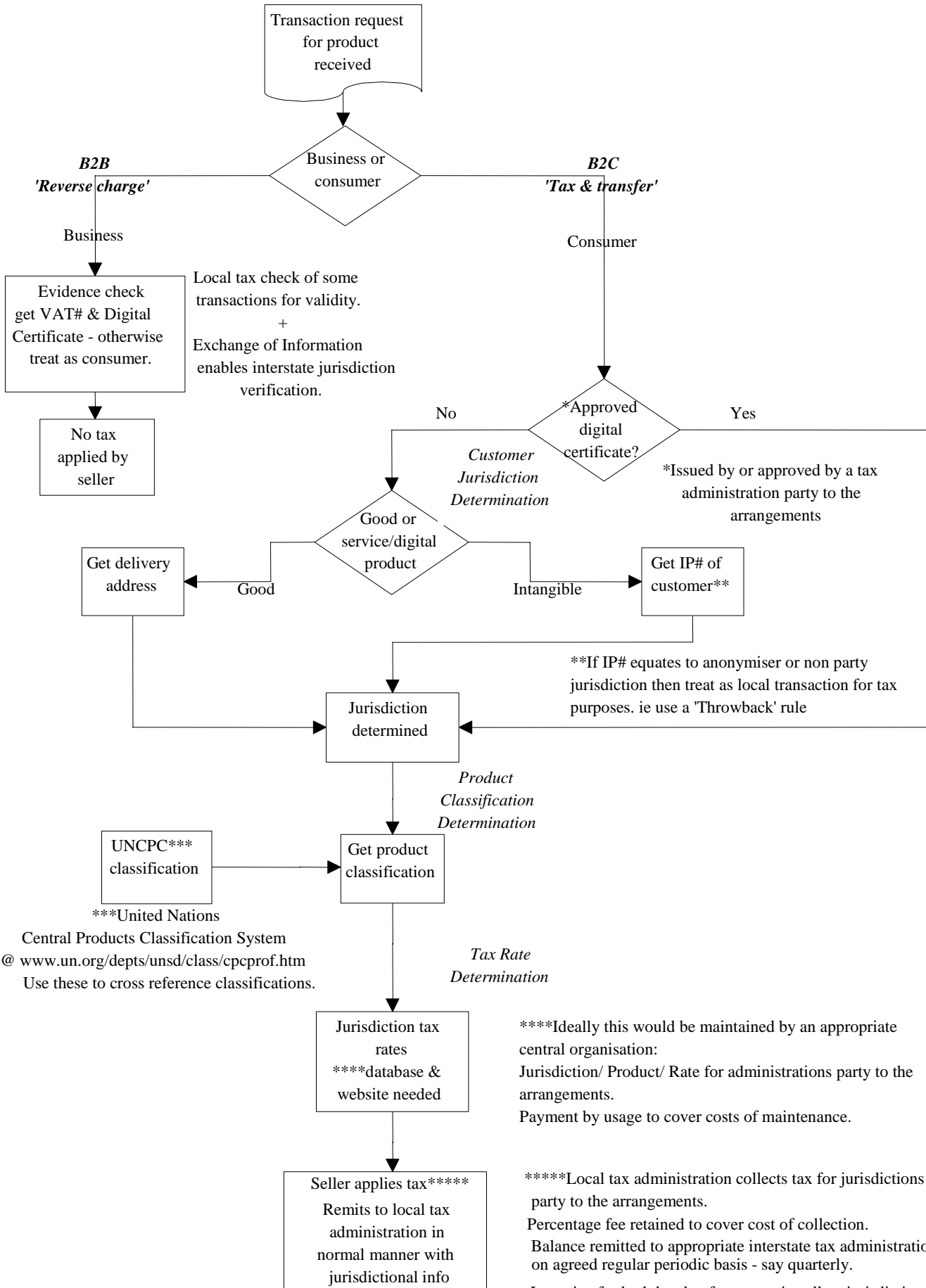
- PlanetAll Online calendar and address book
- Jungle Price comparison search engine
- Internet Movie Database Info source on films business
- Software Store Office and Educational program

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<sup>28</sup> Ernst & Young, 'Global Online Retailing', January 2000, page 25.

# Attachment 2

## Indirect taxes on Interstate Remote Sales

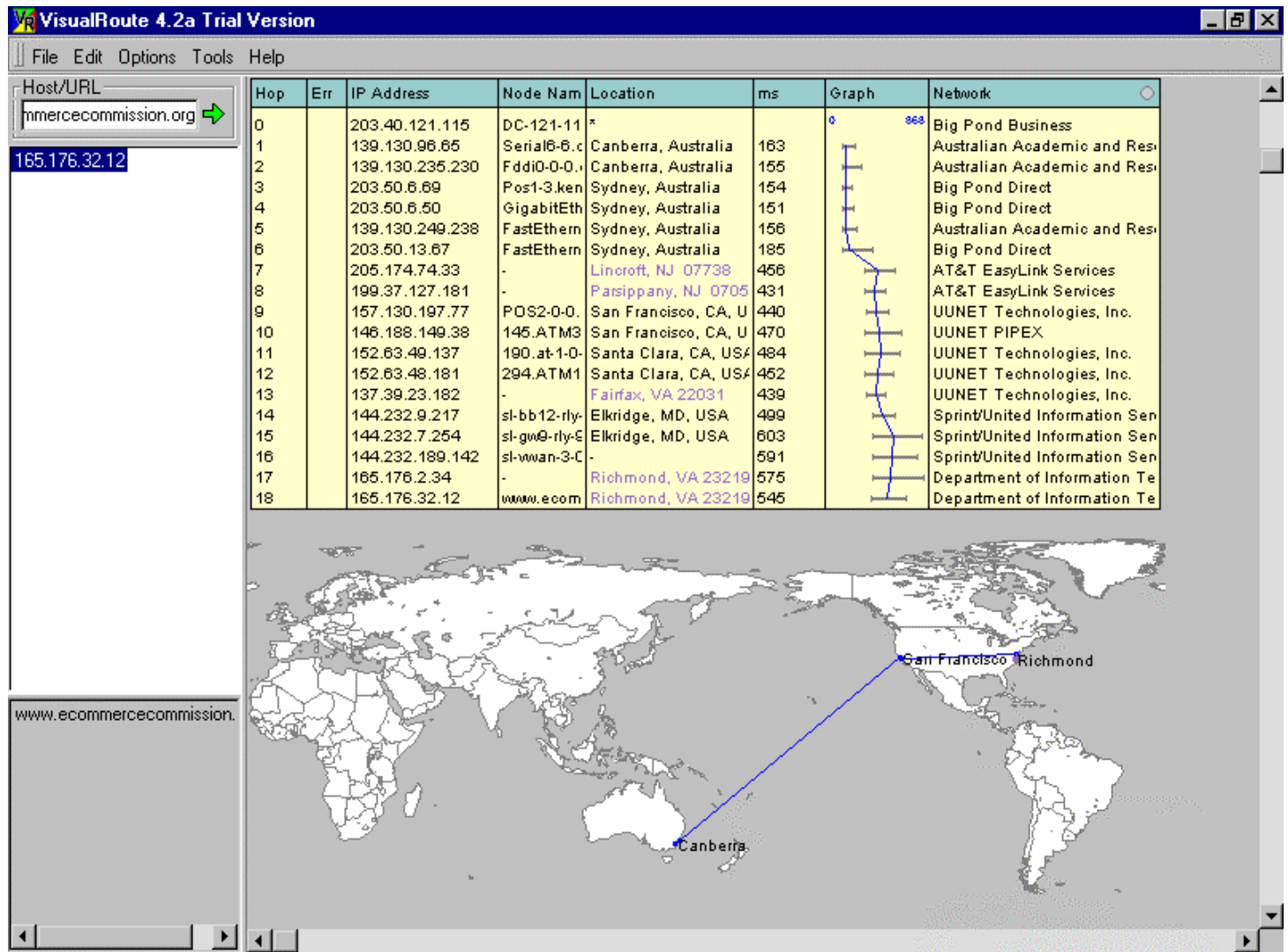


## Attachment 3

### Screen capture of *traceroute* enquiry performed with *VisualRoute*<sup>29</sup>

This enquiry shows the route taken by an Internet 'packet' from the ISP we were using in Canberra, Australia to the ACEC's website. We can see both visually and from the table below that their website is located in Richmond, Virginia.

If we were entering into a business-to-consumer transaction with the ACEC which gave rise to a sales tax liability in Richmond, this enquiry would generally have provided us with sufficient jurisdiction information to progress with the sales tax calculation through the rest of our model.



<sup>29</sup> VisualRoute is available for trial and purchase from [www.visualroute.com](http://www.visualroute.com).