

Comments on Michael Greve's paper: "From Internet Tax Cartel to Competition"

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What is the problem?

“It is commonplace that a problem stated is well on its way to solution” – John Dewey

- It is difficult to collect destination-based sales taxes on **intangible goods and services** sold by **remote** sellers to **non-business** customers due to legal barriers to enforcing tax collection and reporting
- The issue of **business** customers can be addressed through reverse charge (VAT) or use tax (sales tax) enforcement
- Border controls or package delivery companies can be used to collect sales tax on purchases of **tangible** goods
 - VAT on mail order imports into EU
- Examples of intergovernmental cooperation to overcome legal barriers
 - EU VAT on internal mail order (“distance”) sales

Does e-commerce change everything?

“Plus ca change, plus c’est la meme chose” -- anon. French proverb

- Remote (“mail order”) sales have been around since the Sears & Roebuck catalogue appeared in the 1890s
 - The Internet provides an alternative communications channel, often displacing orders formerly placed by mail, telephone, and facsimile
- B2C e-commerce sales account for only 10-15% of total e-commerce sales, and B2B is growing at a faster rate
- The Internet does make possible direct sales of intangible goods and services to remote consumers
 - However, U.S. sales taxes generally do **not** apply to intangible goods and services (unlike VATs and GSTs).

Would an origin-based sales tax be better?

“All is not gold that glitters” – Miguel de Cervantes

- Origin-based sales taxes require **more** inter-gov’t cooperation than destination-based
 - Destination jurisdiction must agree to forego sales tax, otherwise goods imported from origin-tax jurisdiction will bear double taxation
 - Absent such agreement, origin jurisdiction exporters are placed at a competitive disadvantage
 - Inter-gov’t cooperation is difficult to achieve for at least 2 reasons:
 1. Import/export imbalances among jurisdictions
 2. Differences in sales tax rates among jurisdictions
 - By contrast, destination-based taxes in most cases can be imposed without inter-governmental cooperation
 - Direct digital sales to remote consumers are the exception, not the rule

Would an origin-based sales tax be better?

- If origin-based taxation is such a good idea why are there so few success stories?
 - If you were an elected official, would you vote for a sales tax amendment that: (1) imposes tax on exporters; and (2) subsidizes imports?
- The EU experience
 - 1977 – VAT sixth directive formulated – hybrid approach
 - Early 1990's – EC proposes “definitive” (origin) system
 - 1996 – Telecoms switched from origin to destination
 - 2003 – Electronically Supplied Services (ESS) switched to destination basis for imports to, and exports from EU (origin retained for intra-EU sales)
 - 2003 – EC scraps definitive system, proposes destination-based system for all services

Would an origin-based sales tax be better?

“Theory can leave questions unanswered, but practice has to come up with something.” -- Mason Cooley

- Hypothetical origin-based sales tax in the U.S. context:
 - Apply to all goods or just digital goods?
 - If digital only there will be obvious distortions
 - How to prevent double taxation of non-local business customers?
 - Does destination state provide a credit?
 - * If so, will it be reimbursed by the origin state?
 - Does origin state exempt sales to remote business customers?
 - * How does seller verify remote customer's status?
 - * How does origin state enforce this?
 - How do you prevent massive shift in mail order sales to states without sales taxes?
 - Imposition of a “soak-up” tax by origin state would be subject to the same problems as the current use tax.

Can the destination-based sales tax be modernized?

- Current U.S. sales tax has far more fundamental issues than e-commerce
 - Small base (most services exempt)
 - Cascading of tax (about 35% of sales tax revenue is collected from sales to business customers)
 - Direct market sales by non-nexus sellers are subject only to use tax, which is overwhelmingly ignored
 - Over 8000 state and local tax jurisdictions
 - No harmonized product classification system or exemption certificate procedures exist

Can the destination-based sales tax be modernized?

- Technological change caused the “problem” (by allowing direct cross-border supplies of intangible goods and services), but technology and new business models can create solutions too:
 - Harmonized product/service definitions (like Harmonized Tariff System)
 - Digital certificates
 - Certified software systems for e-commerce servers
- **Trusted third party** business models will develop if taxing jurisdictions are willing to provide “collection allowances”

Conclusions

“The sky is falling” -- Chicken Little upon being struck in the head by a pebble

- The relatively minor complications introduced by e-commerce technology have been used by many to justify radical changes in both indirect and direct tax systems
- Destination-based sales tax systems can be modernized to accommodate changes in business models, particularly with enlightened use of technology
- There are few success stories for origin-based sales taxation – it requires a very high level of inter-government cooperation to prevent competitive distortions, double taxation, and shifts in revenue

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