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State Taxation of Electronic Commerce: Perspectives on Proposals for Change and Their Constitutionality

Kendall L. Houghton
Alston & Bird LLP

Walter Hellerstein
University of Georgia School of Law, wallyh@uga.edu

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Kendall L. Houghton and Walter Hellerstein***

Over the past few years, an enormous amount of attention has been devoted to the problems raised by state taxation of electronic commerce,[1] possible solutions to those problems,[2] and, more recently, the question of whether there is a "problem" at all.[3] We have both been, and continue to be, deeply involved in the debate over these issues[4]—a debate that has sometimes generated more heat than light. We view this forum as furnishing us an opportunity to take a step back from the fray and to offer our views not only on the critical issues that are dominating the debate but also on the process by which that debate is being conducted.

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* Partner, Alston & Bird LLP; A.B., Harvard, 1986; J.D., New York University, 1989; L.L.M., Emory University, 1994.

** Professor of Law, University of Georgia; A.B., Harvard, 1967; J.D., University of Chicago, 1970.

1. We could cite countless law review articles for this proposition, but, in the finest academic tradition, we choose to cite our own. *See, e.g.*, Walter Hellerstein, *Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce*, 90 J. TAX'N 5 (1999) [hereinafter *Internet Tax*]; Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 TAX. L. REV. 425 (1997); Kendall L. Houghton, *The Federal Legislative and NTA Tax Project Initiatives on Electronic Commerce Taxation*, J. MULTIST. TAX'N AND INCENTIVES, Sept./Oct. 1998, at 148; Kendall L. Houghton, *Where Electronic Commerce Is Concerned, Caveat Emptor (Let the Buyer Beware): An Analysis of Ongoing Efforts to Define State and Local Taxation Policy*, 97 ST. TAX REP. 8 (1997).

2. *See infra* Part II.

3. *See, e.g.*, Robert J. Cline & Thomas S. Neubig, *The Sky Is Not Falling: Why State and Local Tax Revenues Were Not Significantly Impacted by the Internet in 1998*, 17 ST. TAX NOTES 43 (1999).

4. Before joining Alston & Bird, Kendall Houghton was general counsel to the Committee on State Taxation, the preeminent state tax organization representing the interests of business taxpayers. In that capacity, she spoke and wrote frequently about issues involving state taxation of electronic commerce. She subsequently cochaired the National Tax Association's Communications and Electronic Commerce Tax Project ("Project") discussed *infra* Part II.A. Walter Hellerstein was a member of the Project's Steering Committee and was actively involved in drafting various Project reports. He has also testified as an expert before the Advisory Commission on Electronic Commerce discussed *infra* Part II.B. Both authors also testified before Congress on legislation that became the Internet Tax Freedom Act. *See Internet Tax Freedom Act: Hearing on H.R. 1054 Before the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary*, 105th Cong. (1997).

Part I of this article provides an overview of the issues raised by state taxation of electronic commerce. Part II examines the debate over these issues, and suggestions for their resolution, within the framework of the National Tax Association's Communications and Electronic Commerce Tax Project ("NTA Project" or "Project")[5] and the proceedings before the Advisory Commission on Electronic Commerce ("ACEC").[6] Part III considers the federal constitutional limitations on congressional power to implement proposals addressed to state taxation of electronic commerce.

I. INTRODUCTION

Electronic commerce—the use of computer networks to facilitate commercial transactions involving the production, sale, and distribution of goods, services, and intangible property—has significant implications for state and local taxation, as it does for just about everything else.[7] Electronic commerce provides the environment in which digital products or services are transferred and sold. These products and services include text, sound, video, and other content that can be expressed as series of ones and zeros. Electronic commerce also opens up new avenues for marketing traditional goods and services directly to consumers. It creates similar opportunities for business-to-business transactions involving both digital and nondigital products and services. Indeed, American companies currently make billions of dollars worth of sales to one another over the Internet, several times the consumer retail total, and it is estimated that business-to-business sales could exceed one trillion dollars in the near future.[8]

Unless virtually all predictions are wrong, the growth of electronic commerce will continue to produce a dramatic expansion of

5. *See infra* Part II.A.

6. *See infra* Part II.B.

7. Most of the text of this Introduction is taken directly from NTA, *Communications and Electronic Commerce Tax Project Final Report* (visited Mar. 8, 2000) <http://ntanet.org/>, at 1-9 [hereinafter *NTA Final Report*], which the authors were instrumental in drafting.

8. In 1998, American companies had $43 billion worth of sales to one another over the Internet, five times the consumer retail total, and it is estimated that business-to-business sales will reach $1.3 trillion, or 9.3% of corporate America's purchases, within four years. *The Net's Real Business Happens .Com to .Com*, N.Y. TIMES, Apr. 19, 1999, at C1, col. 3-5, & C6, cols. 3-6 (citing statistics from Forrester Research, Cambridge, Mass.).

commercial transactions occurring through digital networks. The advent of electronic commerce raises a number of questions as to whether and how state and local taxes, particularly state and local sales and use taxes, should be applied to such commerce. These questions include:

- whether the existing state and local sales and use tax system is compatible with an electronic commerce environment;

- whether electronic commerce should be taxed at all considering the difficulty of taxing such commerce;

- whether not imposing or collecting tax on electronic commerce will undermine the sales and use tax base and create inequalities between sales of equivalent goods and services depending on the form or mode of delivery;

- whether the multiplicity of, and inconsistency among, existing state and local use tax laws creates an undue burden on sellers and purchasers in an electronic commerce environment, and, if so, whether it is possible to create greater consistency in state and local sales and use tax laws to facilitate application and administration of such laws in an electronic environment; and

- whether, and under what circumstances, vendors should be required to collect sales and use taxes where they have no physical presence in the state in which their product or service is delivered, assuming a state of delivery can be identified, and where, in some circumstances, vendors may have little or no information regarding their customers' location.

A. Attributes of Electronic Commerce with Significant Implications for State and Local Taxation

Electronic commerce increases the ability of sellers, including those who could not previously sell to a national and international market, to engage in interstate and international commerce through direct interaction with potential buyers. From the standpoint of state and local taxation, such direct interaction enables a wider range of vendors to make sales to purchasers and conduct other business activity in a state without establishing a physical presence there, since they communicate with their customers solely by electronic means.

Another key attribute of electronic commerce with important implications for state and local taxation is that, in principle at least, it allows for provision of digital products and services from remote locations and the receipt of such products and services at remote locations. Regardless of where digital products or services may be produced, they can be transmitted quickly from any location in the world. Such digital products or services can then be offered from that location to customers in any other location in the world that is capable of receiving and storing digital signals.

Electronic commerce also provides enhanced opportunities for engaging in anonymous transactions, i.e., transactions that occur in a manner in which the seller does not know who the buyer is or where the buyer is located. Such transactions may involve the transfer of digital products or services with no verifiable individual or geographic identifiers. They may also involve the payment for such products or services with electronic cash, which likewise contains no verifiable individual or geographic identifier.

We have alluded above to some of the key issues that electronic commerce raises for state and local sales and use taxes. Many of these are variations on issues that have long existed with regard to the sales and use tax. The emergence of electronic commerce magnifies the impact of these issues, making them more significant.

1. Collection responsibility for state and local use taxes

The circumstances under which an out-of-state vendor may be required to collect a use tax that is due to the state from the customer (on products sold to customers within the state) has been the focus of legal and political controversy in the context of mail-order and other remote selling for over thirty years. If increasing amounts of economic activity will be conducted through electronic commerce by remote vendors, the question naturally arises as to which states, if any, would or should have jurisdiction to require collection of sales or use taxes associated with such activity. If states and localities are unable to collect sales or use taxes with respect to such activity, there could be substantial revenue implications for particular state and local governments. In addition, if such transactions effectuated through electronic commerce are not amenable to tax collection for legal or practical reasons, it raises the question of whether taxing the sale or use of equivalent products or services in conventional commerce is equitable. The answer to these questions may raise the fundamental issue posed at the outset of this introduction, namely, whether the existing state and local sales and use tax system is compatible with an electronic commerce environment.

2. Complexity and inconsistency of state and local sales and use tax laws

The complexity within states and the inconsistency among states in the existing state and local sales tax structure has been a major concern with respect to the ability of this structure to accommodate the world of electronic commerce. Although this is not a novel concern to state taxpayers and state tax administrators, it is one that is exacerbated in the context of electronic commerce because of the expectation that more vendors will be selling more products (digital and nondigital) into more states with less contact and less familiarity with the states and their tax systems than ever before. Consequently, the need for simplification of the sales and use tax system is apparent if it is to be a viable and administrable mechanism for raising revenue in the electronic environment.

The principal sources of complexity that most observers have identified in the existing sales and use tax structure are tax rates, the tax base, and tax administration. With respect to rates, the essential problem is the existence of different rates in different localities within a state. These differences raise serious compliance concerns. With respect to base, the essential problems are: (1) the lack of consistent and uniform definitions of goods and services across states, thus complicating vendor efforts to determine taxable and nontaxable goods and services; and (2) the lack of one information resource for what is taxable and not taxable in each state. With respect to tax administration, the concerns relate to multiple and sometimes inconsistent requirements for registration, returns, remittances, exemption certificates, and audits.

3. Telecommunications tax issues

Because telecommunications currently serves as the "backbone" of most Internet transactions, and will compete with other technologies (e.g., cable, satellite) in the future to carry Internet traffic, telecommunications taxation has also been a significant concern. Although many of the issues described under the rubric of "electronic commerce" are equally applicable to telecommunications, state and local taxation of telecommunications raises a number of special concerns. These include the following issues: (1) whether state and local transaction taxes imposed on telecommunications providers and their customers should be applied uniformly, without regard to the regulatory status of the entity providing the service; (2) whether it is possible to arrive at a uniform definition of "telecommunications"; (3) whether the tax system should provide a mechanism for "unbundling" telecommunications from other services for tax purposes; and (4) whether administrative burdens on telecommunications taxation can be minimized, consistent with the legitimate concerns of local governments for revenue, by imposing a single state-wide transaction tax in lieu of various state and local telecommunications taxes.

B. The Role of Tax Policy in Crafting Substantive and Procedural Rules

In the context of these issues and concerns, the challenge is to devise electronic commerce tax policies that embody the important principles which guide all good tax policy, and that would be administrable in light of the new modes of conducting interstate commerce. The principle of economic neutrality (i.e., the system should not influence the choices made by commercial actors regarding how business is conducted) is perhaps the most commonly cited tax policy criterion that drives the electronic commerce tax debate. Other principles that have been cited in this context include uniformity in taxation, transparency of the tax structure, full taxation of commerce, avoidance of multiple or "discriminatory" (i.e., targeted) taxation of commerce, and functional equivalence (i.e., treating functionally equivalent transactions similarly for tax purposes, so as to ensure a "level playing field"). In addition to these traditional tax policy criteria, a critical consideration in the redesign of electronic commerce tax policy for government participants is the concept of "revenue neutrality," or the goal of having the cumulative changes to the existing tax structure avoid any potential revenue drain associated with the non-taxation or limited taxation of electronic commerce.[9]

9. Conversely, revenue neutrality should also protect electronic commerce from bearing heavier tax burdens, at the end of the day, than are imposed under the current state and

Of course, it has been well recognized that these principles may conflict with one another and that one principle may serve as the underpinning for several tax schemes, each of which is inconsistent with the others, for example, with respect to the placement of tax burdens or the design of nexus standards.[10] A scheme that creates a level playing field may impose insuperable administrative costs, yet a tailored nexus rule designed to create administrative ease for electronic commerce transactions violates level playing field considerations. Indeed, it is the effort to reconcile these competing principles, which command virtually uniform support when viewed alone but often irreconcilable conflicts when considered together, that provides the focus for much of the debate over whether and how to tax electronic commerce. We now examine this debate in more detail within the context of the NTA Project[11] and the proceedings before the ACEC.[12]

II. THE SEARCH FOR A SOLUTION TO THE PROBLEMS RAISED BY STATE TAXATION OF ELECTRONIC COMMERCE

A. The National Tax Association's Communications and Electronic Commerce Tax Project

It was in the context of the questions and issues discussed above[13] that the National Tax Association ("NTA") formally convened the NTA Project in early 1997. The NTA is an association with a long and distinguished history as a forum for the discussion and evaluation of tax policy with a broad-based membership from business, government, and academia.[14]

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local tax regime. *See, e.g.*, William J. McArthur, Jr. & Peter R. Merrill, *A Modest Principle: No Net Net Tax* (visited Mar. 8, 2000) <http://www.ecommercecommission.org> (proposal presented to Advisory Commission on Electronic Commerce).

10. *See* Charles E. McLure, Jr., *Achieving a Level Playing Field for Electronic Commerce*, 14 ST. TAX NOTES 1767 (1998).

11. *See infra* Part II.A.

12. *See infra* Part II.B.

13. *See supra* Part I.

14. The following description of the NTA is located at the NTA's Website.

> The [NTA] is a nonpartisan, nonpolitical educational association that fosters study and discussion of complex and controversial issues in tax theory, practice and policy, and other aspects of public finance. NTA is a 501(c)(3) organization and does not promote any particular tax program or policy. The enormous public benefit that can come from sound tax policy and wise administration is a

In November 1996, the NTA cosponsored a Conference on Taxation of Telecommunications and Electronic Commerce in Boston.[15] The Boston conference was the first of its kind to focus on the host of issues raised by taxation of telecommunications and electronic commerce at the federal, state, and local levels. The conference included wide-ranging discussions from markedly different viewpoints of the impact of changes in telecommunications law and technology and, in particular, the development of the Internet, on the federal income tax, state corporate income and sales taxes, and local property taxes and franchise fees.

Despite the significant differences of opinion on many of the critical issues that were voiced at the Boston conference, two themes emerged during the course of the presentations and discussions. First, many of the conference participants appeared to share the view that taxation of telecommunications and electronic commerce, particularly at the state and local levels, raised a series of significant problems that required a uniform, equitable, and administrable solution on a nationwide basis. Second, many of the conference participants likewise appeared to share the view that such a solution could be achieved if representatives of business and government collaborated with one another to resolve these issues. Indeed, the suggestion was made at the close of the Boston conference that an effort be undertaken, with the cooperation of interested parties and academics, to forge a solution to the problems raised by state taxation of telecommunications and electronic commerce through the drafting of a uniform state statute.[16]

The NTA Project brought together representatives of the business community, state and local governments, and academia who shared an interest in identifying possible solutions to the state and local tax issues raised by electronic commerce. The purpose of the

prime reason for the work of NTA.

About NTA (visited Mar. 8, 2000) <http://ntanet.org/>.

15. The following discussion again draws directly from the *NTA Final Report*, *supra* note 7.

16. With the benefit of hindsight, this suggestion appears, at a minimum, to have been premature, based on the sheer number and complexity of issues—of a legal, policy, and procedural nature—that electronic commerce and telecommunications taxation pose. It nonetheless served as the fulcrum for the NTA's decision to convene a "neutral forum" for purposes of the NTA Project initiative.

Project was "to develop a broadly available public report which identifies and explores the issues involved in applying state and local taxes and fees to electronic commerce and which makes recommendations to state and local officials regarding the application of such taxes."[17]

In order to assess fairly the caliber and import of the Project's work product, we believe that it is necessary first to consider the Project's organization and operations, as well as its intersection with contemporaneous federal legislative efforts to address the perceived electronic commerce state and local tax "problem." We then explore each discrete set of issues that the Project undertook to examine and, to a greater or lesser extent, redesign in the context of the Project's Final Report ("Report").

1. NTA Project organization, membership, deliberations, and voting

The NTA Project was designed as an "open" process, in that "[a]ny person, business, corporation, public agency or organization with an interest in state and local taxation of electronic commerce and that wishes to become a member of the . . . Project"[18] could become one and officially participate. Participants believed that the success of the Project—which was essentially an unprecedented effort to formulate tax policies at the state and local level[19]—would depend on the maintenance of openness and balance in the process. In keeping with this policy, all meetings of the Project's Steering Committee were open to the public and to the press.

17. NTA, *Description of the Organization and Operations of the Communications and Electronic Commerce Tax Project* (visited Mar. 11, 2000) <http://ntanet.org/> (accessible from the NTA homepage by clicking on *E-Commerce and Tax Policy*: *Official Documents*: *OD-1*).

18. *Id.*

19. While certain government and taxpayer representative organizations had previously attempted to form consensus-based or negotiated approaches to particular, discrete issues of state taxation, the Project represents the most ambitious cooperative effort to date in this arena. Many Project participants had also been active in such prior efforts by the Multistate Tax Commission ("MTC") and the Financial Institutions State Tax Coalition to draft industry-specific apportionment regulations for financial institutions; the multi-organizational initiative (MTC, Federation of Tax Administrators, Committee On State Taxation, Institute of Professionals in Taxation, and Tax Executives Institute) to draft uniform regulations governing certain electronic business processes that impact sales/use tax administration; the MTC Public Participation Working Groups on the sales/use tax nexus standard and the definition of "business income" for income tax purposes; and the Direct Marketing Association's attempt to negotiate with states a voluntary use tax collection agreement.

This Steering Committee was formed by the initial participants to exercise oversight of the process; it worked to ensure that all Project members had an opportunity to review the various proposals and served as a forum for discussing tax policy issues and organizing the input of Project members into Project recommendations. Sixteen business representatives, sixteen government representatives, and seven "other" representatives were appointed to sit on the Steering Committee; this designation entailed a commitment to remain active in the process and to attend all the meetings, which were held approximately four times a year.[20]

The NTA Board appointed two cochairs[21] to lead the Project and provide liaison with the Board and general members of the NTA. In addition to the Steering Committee, the Project established several other committees and working groups. An Operating Committee assisted with the mechanics of running a voluntary collaborative process; it was comprised of the two Project cochairs and three business and three government representatives from among the Steering Committee members.[22] Early in the process, a Drafting Committee was convened to assist with efforts to draft proposals and to encompass any consensus reached by the Steering Committee; membership on this committee evolved over time but was limited to ensure that it could effectively draft working documents for consideration by the entire Steering Committee. Working groups were also assigned to address specific issues that became important components of the Project.

Because the output of the Project was dependent upon the for-

20. *See* NTA, *Final Report*, *supra* note 7 (listing Steering Committee members). Business representatives were organizations (e.g., Committee on State Taxation, National Cable Television Association, and Information Technology Association of America, among others). Government representatives included one or two individuals affiliated with specific organizations (e.g., National Governors Association, National League of Cities, and National Conference of State Legislatures). "Others" included the American Bar Association, the American Institute of Certified Public Accountants, a U.S. Treasury representative, and three academicians (Professor Walter Hellerstein of the University of Georgia Law School; Dr. Charles E. McLure, Jr., of the Hoover Institution; and Professor Robert P. Strauss of the Carnegie-Mellon University); the seventh "other" slot was never filled.

21. Professor Gary C. Cornia, Brigham Young University (Marriott School of Business) and Kendall L. Houghton, a partner in Alston & Bird LLP.

22. The Steering Committee met nine times between September 1997 and July 1999. In addition, the Operating Committee met separately four times during this period.

mation of "consensus" among the Steering Committee members, an attempt was made to prevent "winners" and "losers" in the grand sense. Consensus, as envisioned by Project participants, implied a generally high level of agreement within the relevant parties, so that no significant faction of the group felt compelled to leave the process and attempt to undermine the result. Of course, requiring consensus also implied that there would not be agreement on some issues and that unanimity was not likely in most instances. Ultimately, "consensus" was translated by the Project bylaws into specific voting requirements to eliminate subjective disagreements over whether or when consensus had been obtained. Voting was to be conducted on any motion introduced by a Steering Committee member, based on a roll call and conducted pursuant to parliamentary procedure. A seventy-five percent vote of those Steering Committee members present (in person or by proxy) was required to approve any motion, with at least six government members and six business members included in the supermajority.[23]

It is clear that the Project's structure and set of procedures helped manage the complexities and the vast array of issues that arose when discussing state and local taxation of electronic commerce. While the process was expansive in scope, the Steering Committee broke down the issues to be voted on relatively early in the process, so that working groups could fully examine and present a diversity of viewpoints and potential resolutions to narrowly framed questions. Each issue or question was presented by the relevant working group for a separate vote, and the Report notes the outcome of these individual motions and votes, with the critical caveat that "nothing is agreed to until everything is agreed to" (i.e., no one vote has significance or effect independent of the other issues being considered and voted on by the Project members).

2. NTA Project as companion and counterpart to the Internet Tax Freedom Act

On March 13, 1997, shortly after the NTA Project was launched but before it commenced official Steering Committee meetings, Senator Ron Wyden (D-OR) and Representative Chris Cox (R-CA)

23. NTA, *Bylaws of the NTA Steering Committee*, § 2.03 (visited Mar. 11, 2000) <http://ntanet.org/> (accessible from the NTA homepage by clicking on *E-Commerce and Tax Policy: Official Documents: OD-14*).

introduced the Internet Tax Freedom Act legislation.[24] The stated goal of the legislation was

> [t]o amend the Communications Act of 1934 to establish a national policy against State and local interference with interstate commerce on the Internet or interactive computer services, and to exercise congressional jurisdiction over interstate commerce by establishing a moratorium on the imposition of exactions that would interfere with the free flow of commerce via the Internet, and for other purposes.[25]

The introduction of the Internet Tax Freedom Act ("ITFA") clearly signaled that its "sponsors and many others in Congress viewed subfederal taxation of electronic commerce (i.e., Internet access, online services, and commerce conducted via these channels) as unwieldy, completely non-uniform and a potential threat to the development and success of new technologies on both an interstate and international basis."[26] Therefore, the ITFA focused primarily on placing a moratorium on state and local taxation of enumerated forms of electronic commerce, with a secondary focus on ways for Congress to "facilitate" (or preempt, depending upon one's viewpoint) the process of developing workable tax policy that would be implemented on an essentially uniform basis by state and local governments.

On the one hand, the philosophy informing the congressional legislative initiative was rooted in the federal government's power to restrain, under Congress's power to regulate interstate commerce under the Commerce Clause, the power of state and local governments to tax electronic commerce. Of course, what's good for the goose can also be good for the gander. Once it became apparent to state and local governments that the ITFA was seriously "in play," then several state and local governmental organizations recognized the opportunity to petition for adjustments in the status quo of state taxation of interstate commerce. These adjustments would employ

24. H.R. 1054 and S. 442, 105th Cong. (1997).

25. *Id.*, at 1.

26. Kendall L. Houghton, *The Federal Legislative and NTA Tax Project Initiatives on Electronic Commerce Taxation*, J. MULTIST. TAX'N AND INCENTIVES, Sept./Oct. 1998, at 148-54. The following discussion draws from this article.

Congress's plenary power over interstate commerce to reduce existing taxpayer protections under the negative commerce clause through the ITFA legislation.

On the other hand, the philosophy informing the Project efforts was, by and large, one of pragmatism combined with a desire to develop objectively "good" tax rules for electronic commerce. The Project participants were careful to acknowledge at the outset that the concerns of government were equally valid and deserving of examination as the concerns of taxpayers, so that the product of the initiative would be viewed as essentially neutral (a critical selling point since adoption of the Project's recommendations presumably would be voluntary).[27] In addition, the Project was serving as a negotiating table for the participants, where changes or concessions would be required of both sides in the pursuit of more workable and efficient rules and procedures for electronic commerce. Successful collaboration, it was projected, would result in greater ease of tax administration and taxpayer compliance in the context of both electronic *and* traditional commerce.

From the standpoint of process and dynamics, as well as the likelihood of success, the intersection of these two initiatives is also intriguing. The number and complexity of the steps required to enact a federal bill and submit it for signature by the President of the United States are so numerous that the potential for successful congressional action (even discounting the political obstacles) is always in doubt. In order to enact the ITFA, an elaborate chain of events, including the following, occurred: (1) identification of willing and "appropriate" cosponsors of a House and Senate bill addressing state taxation of electronic commerce (in light of the sponsors' membership on key committees, status in their party, and in their congressional chamber); (2) identification and coordination of the goals of the prospective legislation, which entailed numerous consultations between the sponsors and business groups and consumers across the country; (3) technical education of the Congressmen's staff members who were responsible for drafting and moving the bills; (4) drafting the ITFA provisions (which resulted in the introduction of identical House and Senate versions, although amendments to each swiftly

27. The question of how to implement any recommendations of the Project was the focus of one working group. That group considered a number of alternatives, including federal legislative mandates to adopt Project recommendations. However, the Project was unable to assume that any option besides state-by-state adoption of its proposals would be practicable.

eroded parity between the bills); (5) referral of the bills to the appropriate committees (in the Senate, the ITFA was referred to the Commerce and Finance Committees, and in the House, to the Commerce and Judiciary Committees); (6) solicitation of cosponsors in each chamber; (7) consideration of the bills and receipt of commentary and suggested changes by the sponsors and committee staffs (i.e., full-court lobbying by interested parties, including government, business and consumer representatives); (8) conduct of committee hearings; (9) multiple introductions of amendments, substitute bills, and alternative bills on the same topic; (10) committee mark-up sessions on the various bills; and (11) upon committee approval, introduction of the amended bills for a "floor vote" by the full chamber. Any number of these steps was repeated with respect to new versions of the legislation.

The original ITFA legislation imposed a six-year moratorium on the imposition, assessment, or attempt to collect any tax on the Internet or online services (including access to or use of communications and transactions that occur through the Internet or online services) by states or political subdivisions thereof. The moratorium was subject to three major exceptions relating to net income taxes, business license taxes, and certain evenly applied sales and use taxes.

After the bill's introduction before the Commerce Committees of both houses of Congress and the Judiciary Committee of the House of Representatives, these committees held three hearings in 1997, and the cosponsors agreed to certain revisions in an attempt to reduce the level of concern with the moratorium expressed by state and local governmental interests. The early versions of the Act called for a "Consultative Group" of federal, state, and local government officials, businesses, representative organizations, and other informed and interested parties to meet for two years subsequent to enactment in order to consider domestic and international taxation of electronic commerce, to explore avenues of resolution, and to provide the President with policy recommendations.

On May 14, 1998, the House Commerce Committee held a hearing and unanimously approved H.R. 3849, a new and significantly revised version of the ITFA. This new bill reflected a compromise negotiated by Representative Cox and the National Governors Association earlier in the spring. Unlike the original approach, which placed a moratorium on all taxes on the Internet and online services with certain enumerated state and local tax preservation clauses, the new approach called for a three-year moratorium on certain specified taxes and otherwise permitted all state and local taxation of electronic commerce. The Act specifically prohibited (during the moratorium period) (i) taxes on Internet access or online services,[28] (ii) bit taxes, and (iii) multiple or discriminatory taxes on electronic commerce.[29]

H.R. 3849 replaced the Consultative Group with a federally appointed ACEC that was to consist of twenty-nine members (fourteen representatives from state, local, and county government organizations; thirteen representatives from taxpayer, consumer, and business interests; and the Secretaries of Commerce and Treasury (or their designates)).[30]

The less active Senate finally followed the lead of the House when it passed its own version of the ITFA on October 8, 1998, by a 96-2 vote. As a result of intensive end-of-session lobbying and conferencing activity, Congress enacted the final version of ITFA (H.R. 4328), which was incorporated into the Omnibus Budget Reconciliation Act of 1998.[31] The ITFA instituted a moratorium for the three-year period beginning October 1, 1998, on (1) state and local taxation of Internet access charges—subject to a grandfather provision for such taxes if generally imposed and actually enforced

28. A grandfather clause permitted state taxes on Internet access or online services "generally imposed and actually enforced" prior to March 1, 1998. However, to activate the clause, states with such taxes in force must have enacted a law that expressly imposes such taxes within one year of the Act's enactment.

29. A later-amended substitute House bill, H.R. 4105, was introduced and passed the House by voice vote on June 23, 1998. The bill was similar to H.R. 3849, but there were three notable differences: (1) it added two individuals to the Commission (another business representative plus the Attorney General or their designate); (2) it specifically identified all existing state taxes on Internet access that may be subject to "grandfathering" under the moratorium provision; and (3) it indicated that the Advisory Commission "may," not "shall," address the enumerated agenda items set forth in the bill in drafting its model legislation.

30. The final version of the ITFA (H.R. 4328) changed this provision so that the ACEC membership consisted of eight business representatives, eight state and local government representatives, three federal government representatives (for the Secretaries of Commerce and the Treasury and the U.S. Trade Representative). The commissioners were authorized to select the ACEC chair, and the House and Senate majority and minority leadership divided appointments to the ACEC.

31. The ITFA in its enacted form also incorporates provisions relating to protection of minors from inappropriate materials on the Internet. While the merging of tax and censorship provisions is somewhat awkward, the basic thrust of the ITFA remains the same.

prior to October 1, 1998—and (2) "multiple taxes" or "discriminatory taxes" on electronic commerce.[32] The ITFA states that it is not to impact state and local taxation in any other capacity, nor affect liability for ongoing litigation relating to taxes accrued prior to enactment.[33] The ITFA charged the ACEC (in slightly restructured form) with producing a study and corresponding legislative recommendations, as discussed below.[34]

When contrasted with the legislative process described above, the dynamics of the NTA Project tended to be quite different. First, the operational features of the Project developed as the initiative proceeded and were adjusted to some extent over time as the needs of the group changed. Second, the lobbying conducted in the NTA Project context had to be directed to one's business or government counterparts, not to an independent third party. Therefore, the interactions were more direct and undiluted. Third, the tone was arguably less emotional, except when the Project addressed the "core issues" for an interest group (e.g., loss of state sovereignty or local autonomy for the government representatives or reduction of dormant Commerce Clause nexus protections for remote sellers for business representatives).

Furthermore, the Project participants generally exhibited a more patient and cautious approach toward even the emotional or otherwise difficult issues than did participants in the advocacy-driven federal legislative process. This may be explained by the fact that the Project's success depended upon everyone staying in the room together to achieve the necessary "consensus" that was essential to the Project's output. Because there would be no output without "consensus," and because most of the participants felt that the output of the process was critical to them, they continued to communicate and deliberate to achieve a goal that could not be obtained in the absence of such communication and deliberation. By contrast, while the federal legislative process is supposed to yield an outcome that is roughly fair to all sides, or at least representative of a melding of

32. Internet Tax Freedom Act, Pub. L. No. 105-277, §§ 1101-04, 112 Stat. 2681-719 (1998) [hereinafter ITFA]. For a detailed analysis of the substantive provisions of ITFA, see Hellerstein, *Internet Tax*, *supra* note 1.

33. ITFA §§ 1101(b)-(c).

34. *See infra* Part II.B.

viewpoints, there can clearly be "winners" and "losers" in the legislative process, depending upon how well the interested parties have allocated resources, crafted alliances, and promoted their agendas.

Interestingly, the ITFA provides that "[t]he [ACEC] shall, to the extent possible, ensure that its work does not undermine the efforts of the National Tax Association Communications and Electronic Commerce Tax Project."[35] Both initiatives were conducted with complete awareness of the other, and this directive seems to suggest that Congress valued the projected output of the Project. In fact, participants in the Project lobbied Congress to include the Project, or representatives thereof, in the ACEC structure or, at least, to require the ACEC to take any Project recommendations into account in forming its own recommendations. Nevertheless, the fact that the Project discussions were being conducted largely by tax technicians, as opposed to high-level corporate and government representatives, may have concerned the ITFA sponsors and supporters, who took a more expansive view of the stakes in this debate—including the national economic importance of new technology-driven industries and the international competitiveness of U.S. business and technologies. Hence, the ACEC was free to consult with the Project, to review Project output, or to ignore the Project, so long as the Project was not intentionally undermined by the ACEC's own work in exploring taxation of electronic commerce. The work of the NTA Project continued apace during the incubation period of the ITFA, but the question remained whether the NTA output would be a companion to, or incorporated into, the output of the federally appointed ACEC.

3. *The NTA Report*

The NTA Report examined seven major areas of inquiry, describing the various perspectives on how the issues might be resolved and taking note of any Project consensus or recommendations regarding particular issues.[36] At the outset, however, the Project members felt that the NTA Report must clarify the context in which Project members considered all of the issues, and in which the Project reached any consensus or recommendation. The "Prefatory Caveat"

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35. ITFA § 1102(h).

36. The following discussion draws freely from Kendall L. Houghton & Gary C. Cornia, NAT'L TAX J. (forthcoming 2000).

to the NTA Report therefore states:

> One working assumption underlay all the work of the project, to wit: "*Nothing is agreed to until everything is agreed to.*" Consequently, the Steering Committee wishes to emphasize at the outset that it would seriously misrepresent the work of the Project to pluck any of its tentative and preliminary conclusions, including specifically those it reached by a formal vote, out of context and to represent them as the conclusion of the Project.[37]

Nevertheless, for purposes of this article, we examine each section of the Report independently, because it enables us to describe the framework in which each of the major inquiries was undertaken and to discuss important features of the Project's deliberations that were not reflected in the Project Report. In many instances, this "editorial" commentary will shed light on the motivations or goals of the proponents of proposals that have since been submitted to the ACEC[38] and of current federal legislative initiatives relating to taxation of electronic commerce.

a. Sales and use tax rates. The myriad existing state and local sales tax rates (based on the Report's estimated 7,600 jurisdictions across the country that impose a local sales and use tax) imposes a compliance burden on multistate sellers. This problem has the potential to become even more serious as numerous small sellers enter the market for the first time. The problem centers on identifying the appropriate tax rate to charge, which in turn requires identification of the destination jurisdiction. Most solutions to this problem require the purchase and maintenance of software that can track all transactions for sales tax collection. There is also a concern that it may be difficult to keep the system current as additional jurisdictions adopt local option rates and existing rates are changed.

Virtually every member of the Project agreed that the current rate structure is complicated and potentially very costly for nontraditional marketing firms. These same individuals also recognized the importance of revenue to local governments and the role sales tax revenue plays in funding basic government services like public safety

37. *NTA Final Report*, *supra* note 7, at 10.

38. *See infra* Part II.B.

and general government operation.[39] There was also a realization that the local option sales tax has gradually been replacing the less popular property tax as a major source of local funding. Thus, no movement to constrain the use of local option sales taxes could be undertaken unless the states were willing to hold local governments harmless. Nevertheless, the Project did adopt as a consensus position that there should be one sales tax rate in each state that has adopted the sales tax and granted the use of local option taxes for substate-level governments. The "one rate per state" recommendation was tempered by the additional recommendation that states devise methods to protect and continue the equitable distribution of revenues to local jurisdictions

In addition to "one rate per state," the Project considered other solutions to the problem of multiple rates. These alternatives focused on simplifying the current rate system without adopting a single rate in each state. Alternatives included conforming tax jurisdiction boundaries to zip code or zip-plus-4 boundaries, using a Geographic Information System (GIS) to identify the locale of consumers, and adopting a two-rate structure with one rate for over-the-counter transactions and one for remote transactions.

The Project also explored related issues such as how a single rate per state would be established (i.e., at the current highest or lowest combined state and local rate, at an average rate, or otherwise) and what effect this measure would have on revenue neutrality, equity among communities that currently levy different substate rates, and potential revenue windfalls or shortfalls. Project members also expressed concern over the frequency of rate changes and the provision of adequate notice of such changes.

While the Report did not articulate the point, it was clear that most government representatives viewed their approval of the "one rate per state" motion as linked to the adoption of means to protect state and local governments against fiscal losses resulting from the migration of commerce to the Internet. Indeed, the topic of "duty to collect" sales and use taxes and the expansion of vendors' obligations beyond those required by existing constitutional principles was the very next agenda item that government participants wished to address, effectively as a quid pro quo for this consensus. The fact that

39. Local sales taxes are also used in some states to fund education and mass transit and to guarantee bond-issue debt.

business participants refused to premise an expanded duty to collect such taxes upon the "one rate per state" recommendation, without significant *additional* simplification measures—and possibly not even in exchange for that package of government concessions—caused a great deal of tension over the meaning of the vote on the rate issue. As a result of this controversy, the Steering Committee agreed to examine each set of issues in turn, without engaging in binding action on any particular issue, and it also developed the mantra that is incorporated into the Report's Prefatory Caveat: "nothing is agreed to until everything is agreed to."

b. Duty to collect sales and use taxes and other jurisdiction-to-tax issues. The relatively limited attention devoted to questions bearing on the duty to collect sales and use taxes and analogous jurisdiction-to-tax issues presents a misleading picture of the relative importance of the issue to the NTA Project's discussions. The issue of tax jurisdiction—"nexus"—has long been the focus of heated controversy in the state and local tax arena for *all* types of remote commerce and *all* types of taxes. Long-standing tensions, resentments, and mistrusts probably presaged the lack of consensus on these issues, and familiarity with that background is essential to a full understanding of the summary treatment of the issue in the NTA Project Report.

Some government representatives have argued that the physical-presence requirement for Commerce Clause "substantial nexus," as enunciated in *Quill Corp. v. North Dakota*,[40] is not applicable to taxes other than sales and use taxes. These advocates rely on language in *Quill* suggesting that the bright-line test had a historical application in the context of sales and use taxes (i.e., the Court had articulated the physical-presence standard in an earlier use tax case, *National Bellas Hess, Inc. v. Department of Revenue*[41]) but did not control other types of tax cases.[42] Taxpayers have responded to this argument by noting that the Court stated clearly in *Quill* that:

40. 504 U.S. 298 (1992).

41. 386 U.S. 753 (1967).

42. Moreover, it has been argued that in the current environment, where businesses exploit multistate markets on a regular basis and multistate sellers have access to commercially available tax collection software, lowering the nexus threshold for *either* sales and use taxes or direct business taxes would not upset "settled expectations," nor would this action constitute an "undue burden on interstate commerce" so as to violate the dormant Commerce Clause.

> [A]lthough our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all established "bright-line" tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rules.[43]

While the Supreme Court has yet to address this question, various states have attempted to resolve the ongoing nexus controversy in their own courts, both by reference to constitutional jurisprudence and their own statutory schemes.[44] In addition, attempts have been made by state governmental representatives, working with Congress, to enact "corrective" federal legislation designed to require remote sellers to collect sales and use taxes on interstate transactions, assuming at least a de minimis level of sales, either nationally or on an in-state basis.[45] Business representatives, however, have regularly and vehemently opposed state-supported efforts to have Congress affirmatively reset the judicially-established Commerce Clause sales and use tax nexus bar at a lower level—as the Supreme Court in *Quill* explicitly invited Congress to do if Congress did not agree with the Court's creation of a bright-line physical-presence standard of "substantial nexus" for use tax collection purposes under the dormant Commerce Clause.

Moreover, organizations such as the Direct Marketing Association, the Federation of Tax Administrators, and the Multistate Tax Commission have undertaken a series of efforts—to date unsuccess-

43. *Quill*, 504 U.S. at 314. In this vein, "the Court also noted expressly that all of its prior decisions upholding taxes against Commerce Clause challenges, including the modern cases on which North Dakota placed reliance, involved taxpayers who, in fact, did have a physical presence in the taxing state." John L. Coalson, Jr. & Fred O. Marcus, *What Is 'Substantial Nexus' After Quill?* 2 ST. & LOC. TAX LAW 17, 26 (1997).

44. *But cf.* J.C. Penney Nat'l Bank v. Johnson, No. M1998-00497-COA-R3CV, 1999 WL 1206684 (Tenn. Ct. App. Dec. 17, 1999); Crown Cork & Seal (Del.) Inc. v. Comptroller of the Treasury, No. C-97-0028-01, 1999 Md. Tax LEXIS 4 (Apr. 26, 1999); MCI Int'l Telecomm. Corp. v. Comptroller of the Treasury, No. C-96-0028-01, 1999 Md. Tax LEXIS 5 (Apr. 26, 1999); SYL, Inc. v. Comptroller of the Treasury, No. C-96-0154-01, 1999 Md. Tax LEXIS 3 (Apr. 26, 1999); Cerro Copper Prod., Inc. v. Department of Revenue, No. F-94-444, 1995 Ala. Tax LEXIS 21, at *6-14 (Ala. Dept. Rev. Dec. 11, 1995); Geoffrey, Inc. v. South Carolina State Tax Comm'n., 437 S.E.2d 13 (S.C. 1993).

45. *See, e.g.*, *The Consumer and Main Street Protection Act of 1997*, S. 1586, 105th Cong. (1997); *The Consumer and Main Street Protection Act of 1995*, S. 545, 104th Cong. (1995).

ful—to negotiate a voluntary agreement between remote sellers and states, whereby the seller would agree to collect use taxes in exchange for certain concessions regarding the voluntary tax remitter's administrative compliance burdens.[46] However, none of these initiatives—judicial, legislative, or negotiated—has defused the controversy between states and taxpayers over appropriate nexus standards, and the stakes are viewed as particularly high by both sides.

Against this background, the Project's general discussions focused on the extent of a seller's obligation to collect sales and use taxes and the appropriate definition of "nexus" for purposes of electronic commerce. The Project members explored three alternative proposals during these discussions. The first was to replace the current nexus standard with a collection duty premised upon a vendor's national or individual single state sales volume. Advocates of this approach cited the following benefits: (1) establishing a "true" objective "bright line" test (i.e., no subjective examination of de minimis physical contacts but rather review only the dollar level of sales); (2) substantially eliminating or reducing nexus disputes; (3) recognizing the contributions of state and local governments to supporting commerce; and (4) fostering a level playing field among vendors selling into the same marketplace.

The second suggestion was to maintain the current nexus standard established in such cases as *Quill*[47] and *Oklahoma Tax Commission v. Jefferson Lines, Inc.*[48] Advocates of this approach cited the

46. During 1997-98, the Direct Marketing Association ("DMA") attempted to negotiate a Limited Contacts Taxpayer Agreement with certain states' administrations and with the informal technical advice of the Federation of Tax Administrators and Multistate Tax Commission. This agreement was designed to address the long-standing tug-of-war between states that are not collecting use taxes from their own residents and mail-order sellers who have successfully argued that they lack nexus for purposes of collecting these same use taxes on sales they make into states where they are not physically present.

The DMA indicated that if states and localities offered mail-order sellers the right incentives—in the form of simplified collection and reporting obligations and a safe harbor for substantial compliance with state and local use tax laws—then those sellers would in large part voluntarily come forward and register to collect taxes, thus making nexus a moot point. This draft agreement was intended to embody the terms on which voluntary collection would ensue. However, the effort was unsuccessful due in part to unfavorable media coverage and resultant negative consumer reactions.

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

48. 514 U.S. 175 (1995).

following benefits: (1) protecting interstate vendors from the patchwork of burdensome and inconsistent state and local tax obligations as contemplated by existing case law; (2) insulating remote vendors from tax collection duties in jurisdictions where they effectively received no direct governmental services or benefits; and (3) maintaining an appropriate reliance upon well-established Supreme Court precedents.

The third suggestion was to clarify further the physical presence (in both qualitative and quantitative terms) that is necessary to establish a vendor's duty to collect the sales or use tax. Advocates of this approach cited its benefit of reinforcing existing Supreme Court precedent while further reducing the possibility for nexus disputes that might arise from unclear or inconsistent interpretations by the states of existing nexus standards. In fact, proponents of this approach offered up a list of physical contacts and activities within a state, by or on behalf of a vendor, that should be subject to a nexus "safe harbor" akin to that created by Public Law 86-272 for net income tax purposes. Proponents of these proposed safe harbor contacts noted that many of them constituted contacts by the vendor-as-consumer, rather than as seller, of goods and services within the subject state—in which case, they argued, the contacts benefited the state but did not constitute sales or use tax nexus contacts of the sort that "establish and maintain a market in [the] state."[49]

While all Project participants clearly understood the relevance and ramifications of considering an expanded duty to collect sales and use taxes, the discussions did not reach a consensus as to the appropriate outcome. Some of the business representatives did not feel inclined to make any concessions on their current constitutional protection unless and until simplification procedures that substantially eased their compliance burden were already in place.

Even more critical to the log-jam, however, was their conviction that any change in the nexus standards for sales and use taxes would necessarily have nexus implications for other types of direct business taxes (e.g., net or gross income taxes, franchise taxes, and other taxes borne directly by the business entity). This concern was among the most contentious of all the issues reviewed during the Project. Government officials conceded that expanded sales and use tax nexus

49. Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 U.S. 232, 250 (1987).

could be viewed as a precursor to alteration in the current (precarious) balance for other types of taxes.[50] However, they professed to believe that a series of safeguards could be adopted to prevent this spillover effect. One suggestion was implementing a rule that registration for sales or use tax purposes could not be construed by the state as establishing nexus for other taxes. Attempts to find an acceptable solution to this concern were not successful.

The business group as a whole eventually espoused the position that a physical presence test should become the accepted nexus standard for *all* types of taxes, but at the very least for sales and use taxes. Other participants in the Project, primarily the government and academic members, rejected the status quo as an acceptable approach to electronic commerce and urged the adoption of a nexus test based on economic activity (e.g., a sales threshold) with the development of safeguards or an articulation of a "firewall" for purposes of distinguishing nexus standards for direct business taxes. Not surprisingly, the Project participants could not resolve this issue in a manner that satisfied the consensus requirement of the Project.

c. Sales and use tax base. The diversity of state and local tax bases creates significant complexity for sellers doing business in multiple states and attempting to comply with sales and use tax requirements. Exemptions vary between states and within some states and may be based on the specific good or service, the manner of use of the good or service, the status of the purchaser of the good or service, and whether the good or service is being purchased for resale. There was general agreement among the Project participants that the current system was difficult to track for multistate sellers. One obvious solution to such a situation would be the development of a uniform standard for the taxation and exemption of goods and services. However, the Project members unanimously rejected this approach,

50. In fact, many states have contended in income and franchise tax nexus litigation that the nexus standard for these taxes is, *at worst*, no more stringent than in the sales and use tax context pursuant to dicta contained in *Quill* and, at best, is not premised upon the entity's physical presence within a state at all, but rather, its mere economic presence. *See* Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C. 1993). Therefore, they have reasoned, any downward adjustment to the dormant Commerce Clause nexus standard that *Quill* enunciates—whether through voluntary expansion of the duty to collect (i.e., a waiver of constitutionally available protections) or through congressional action to adjust the nexus standard—would have a corresponding impact on nexus for other types of taxes.

because they recognized the importance of reinforcing state sovereignty in regard to determinations of what would or would not be included in their sales and use tax bases.[51]

The Project instead adopted an approach that explored the development and implementation of uniform definitions or classifications of products and services for tax base purposes. Under this system, states would continue to determine the taxable status of products and services, but the definition of each enumerated good and service would be consistent between and among the states. The Project determined that such a tax base "menu" would need to contain sufficient detail to enable it to be capable of corresponding, to a great degree, to the states' current tax bases. This approach would simplify the transition to a new articulation of each state's tax base, as well as the development of software that would enable sellers to determine whether their product or service was taxable in each customer's state.

The Project identified and evaluated potential sources for uniform definitions of product and services. It considered four different classifications: North American Industrial Code System, United States Harmonized Tariff Schedule, Bureau of Labor Statistics Expense Categories, and United Nations Centralized Product Classification ("CPC"). Generally, the Project participants felt that the classification system with the highest potential to serve as a starting point for a uniform state sales and use tax base menu was the CPC system. The other three classification systems had one or more flaws: their focus on the production side of the economy in classifying goods and services, their lack of attention to services (e.g., they only defined or classified goods), or the fact that they were extremely detailed and would have been precise but too detailed for state usage (or, at the opposite extreme, lacking sufficient detail to offer much guidance to state lawmakers).

The Project did not formally recommend the CPC system. However, the Project members encouraged a continued study of the potential use of the CPC and the U.S. Census Bureau's efforts to create integrated classification systems for both goods and services based on

51. In this regard, both business and governmental representatives agreed that the ability of states to use tax base determinations to promote specific social and economic policies, e.g., to create incentives for (or "punish") certain actors or products, was a key feature of the division of powers inherent in our federal system of government and an ability that both sides valued greatly as a means to promote competitiveness of states *and* of industries.

the CPC system.[52]

The Project also considered the treatment of exemptions by states from sales and use taxes. Exemptions, while an important tool to effectuate tax policy, create compliance complexity and exposure to audit risk. The Project explored several options to reduce the problems associated with nonuniform exemptions. One approach considered in some detail was the development of model exemptions relating to business inputs (e.g., sales for resale, purchases that become a component of another product, items used or consumed in the manufacturing process, and agricultural equipment and supplies) that would encourage states to standardize their treatment of business purchases.

Finally, the Project reviewed several additional measures that might reduce the instances of inconsistent treatment of identical tax base items, including (1) utilizing set rules of interpretation (such as those devised by the UN for the CPC system); (2) requiring states to come to agreement among themselves as to which interpretation is correct, as an initial matter; and (3) as a last resort, establishing a "competent authority" to rule on inconsistencies. In combination with a process to ensure that the tax base menu would be "dynamic" (i.e., able to accommodate the development of, and define, new goods and/or services), the Project viewed a limitation of the frequency of such change as potentially useful.

d. Sourcing transactions for sales and use tax purposes. The traditional practice of sourcing sales transactions to the taxing jurisdiction where the product or service is purchased or consumed works well when buyer and seller are engaged in routine commercial exchanges. However, destination-based sourcing is more complicated in an era of electronic commerce because the point of consumption is not always known to the seller (e.g., in sales of digital products or services delivered via the Internet or other electronic means, or in instances where buyers of goods or services have multiple users who access digital products from multistate locations). Within this context, the

52. The Project recognized that the Multistate Tax Commission was undertaking an initial study of the similarity between the United Nations CPC system and the existing tax bases of three states to determine the degree of synchronicity between them and the potential for utilization of the CPC system as the basis for developing a uniform tax base menu for the states.

Project entered into a series of discussions regarding the proper sourcing of sales.

The Project Steering Committee adopted a consensus position (ratified by a formal vote, subject to the Prefatory Caveat[53]) that sales should be sourced to the state level only (not to a substate level) and that the sourcing should be based on the state of use or destination of the product or service purchased. The Project also recommended that uniform procedures be developed to protect out-of-state vendors from audit exposure in situations where, after a good faith effort on their part, the destination of the product or service could not be determined.

The Project participants felt that this recommendation would enable transactions to be sourced to the point of destination without imposing a set of requirements that would be unduly constricting on sellers in terms of their information gathering or verification duties:

> This should increase the proportion of transactions for which the requisite sourcing information is available in the normal course of business. It should also reduce potential burdens and complications for sellers as well as reduce concerns about intrusions into matters of privacy and personal information, compared to other alternatives. The recommendation helps avoid drawing distinctions between forms of commerce (*e.g.*, electronic vs. mail order) or types of products (*e.g.*, digital vs. tangible).[54]

This recommendation nevertheless raised concerns for those members of the Steering Committee who believed that failure to source sales to the local taxing jurisdiction would undermine local fiscal autonomy. In this regard, the Project members again examined tax rate concepts proposed as an alternative to "one rate per state"—such as zip codes or the use of two rates (one for "over-the-counter" and one for interstate or in-state remote sales)—and they again rejected such alternative proposals. Zip codes do not necessarily correlate to local taxing jurisdictions, and a two-rate system would violate the goal of tax neutrality by treating identical transactions differently solely by reference to the means by which they were conducted. Likewise, a two-pronged sourcing approach, whereby digital products are sourced only to the state level but tangible property is sourced to the local level, was rejected as violating the principle of tax

53. *See supra* text accompanying 37.

54. *NTA Final Report*, *supra* note 7, at 32-33.

neutrality. In response to the concern of local government representatives, the Project recommended that the states devise a fiscal transfer system to protect local governments from potential revenue losses.

There were also proponents of sourcing Internet sales, if not all sales, on an origin basis. The argument that an origin-based tax would be easier to administer for vendors seems apparent (e.g., a single rate, a single set of exemptions, and a single administrative system with which to comply for each sales location of the vendor). Nevertheless, all but a few members of the Project Steering Committee rejected this proposal as completely undermining the conceptual foundation of a retail sales tax operating as a consumption tax. Virtually everyone connected with the Project found the origin-based tax concept objectionable because it would amount to a tax on production and exports and lead to economic distortions favoring sellers that located in a state without a sales tax.

Still, the method of sourcing sales where the destination address is unknown remained unresolved. There was a consensus that sales should not be exempt from taxation solely because information on the actual state of destination or use (or the acceptable proxies therefor, if any) is not known to the seller. In connection with the Project's resolution to develop one or more default rules for such situations, the Project members examined two alternative default sourcing rules.[55] The first was termed the "throw-back" rule; this rule would source the sales back to the state of origin (i.e., the vendor's location) in the absence of sales destination information. Considerations of administrative ease support this approach, but it raises policy problems because states without a sales tax could become tax havens for online and other remote sellers. The second alternative was termed the "throw-around" rule. Under this rule, sales without readily available destination information would be pooled and allocated to states (for purposes of imposing a sales or use tax on the sales) that impose a sales tax on an agreed-upon allocation formula. Administratively speaking, this approach creates more difficulties, but it does not create disincentives with respect to vendor behavior (i.e.,

55. Both alternative default rules were presented to the Project in Report No. 1 of the Drafting Committee of the NTA Project (1997), *reprinted in* 13 ST. TAX NOTES 1255 (1997).

no jurisdiction becomes a "haven" for sales tax purposes). Project members did not reach an agreement with respect to the advisability of recommending either of these default rules.

One other concern troubling business representatives in the discussion of developing sourcing rules was their liability for failing to satisfy state auditors that they had expended sufficient efforts to collect destination data from buyers. In this connection, the Project members discussed several suggestions for safe harbors that would protect sellers that were not acting in bad faith[56] in securing sourcing information from the buyer. These safe-harbor proposals included the following: data provided by the buyer would be assumed to be correct; decisions on conflicting data would be left with the vendor; vendors would be required to collect only information from the buyer that would normally be collected during a transaction; when a buyer refused to provide sourcing information, the transaction would be subject to the applicable default sourcing rule; and, when a seller knows the sourcing data provided by the buyer is false, based on information readily available at the time of the transaction, the sale would be handled in accordance with a default rule.

e. Simplification of state and local sales tax administration. Nearly all Project members agreed that the current administrative and compliance system is complex and costly. The burden is most apparent for multistate vendors who must comply with a multitude of laws and regulations. It is anticipated that this problem will become more severe as small vendors increase their marketing via the Internet. Therefore, the Project concluded that any examination of electronic commerce sales and use tax issues must deal with this broad set of issues.

The Project's discussion of simplification centered on steps to simplify specific aspects of sales tax administration and to increase uniformity between the states. While the Project did not adopt a formal recommendation on simplification, it did consider a series of specific proposals that could be implemented and would reduce the

56. The Project defined the term "taken in bad faith" as follows:

> A seller's reliance on required sourcing information or resolution of conflicting sourcing information is "taken in bad faith" (and the seller is outside the safe harbor) if the seller has assisted in securing, or promoted the receipt of, false sourcing information with the intent that the information if accepted as true will permit the avoidance of taxes otherwise due.

NTA Final Report, *supra* note 7, at 47.

burden of sales and use tax compliance.

The Project members discussed three approaches to simplification. Two of these, denominated Base State Tax Administration and Real Time Tax Administration, were carefully considered but in the end were regarded as too complex and uncertain to implement at this time. The Base State system would require a multistate seller to deal on most matters of tax administration (e.g., registration, return filing, tax remittance and audit) with only one state—its base state (i.e., state of commercial domicile or principal operations). Proponents of this system cite as its advantages a quick and dramatic reduction in administrative burden for interstate sellers and its effective use in the context of fuel use tax administration (i.e., it is proven). Opponents of this system, on the other hand, were concerned that the sales tax system is too complex to have one state administer a multistate tax regime; that the fuel use tax system is origin-based, and thus its administration system would not translate well to a destination-based sales tax environment; and that adoption of this system might adversely affect cash flow of some states.

The Real Time Tax Administration system contemplates the use of electronic technology currently employed to process credit card purchases to administer the sales and use tax collection and remittance function (including taxability determinations, selection of tax rates, collection of tax, remittance to appropriate tax jurisdictions, and appropriate reporting). The system contemplated that the states would arrange with private sector interests to develop and implement this system. Proponents of a Real Time Administration system observed that it would relieve vendors of the burden and the corresponding liability for tax collection duties and that state tax administrators would retain control of the technology. Many others, however, expressed concern that the technology is not available today, that the system's complexity renders this solution too costly to develop, that the system would in any event contain numerous flaws, and that, for these and other reasons, consideration of such a proposal was premature at this time.

The third approach—which the NTA Report states represents "the most realistic approach to achieving significant simplification in the near term"—was to improve the current system. Improvements would be realized through the redesign of various administrative and compliance processes. Suggestions for such a redesign included uniform vendor registration (e.g., a national or multistate vendor registration form as an option to existing state-specific forms); uniform sales and use tax returns (which might reflect streamlined sales tax rates, sales tax bases, and less frequent filing and tax remittance requirements); electronic filing of returns; uniform state laws on bad debt deductions (i.e., where a vendor is not fully compensated for a purchase due to insufficient check funds, terminated installment sales and other bad debts); increased use of "direct pay" permits (i.e., where vendors directly remit use tax on their business purchases of goods and services); uniform resale exemption certificates and other exemption administration processes (including establishing a reliance and indemnification standard for vendors who are provided with such exemption documentation—although this standard was not agreed upon); vendor compensation (i.e., relating to the cost of collecting and remitting these taxes, as that cost is reflected in the complexity, or lack thereof, in the system); and simplified audit and appeal procedures (including consideration of so-called Base State and Customer Tailored Approaches to reducing the number of states that may audit or review appeals of vendors).

Simplification of the current sales and use tax administration is critical, regardless of whether consideration is given to extending the duty to collect tax to certain remote sellers. The work of the Project indicates there are a number of avenues that can provide meaningful simplification in pursuit of that goal. Indeed, the proposals that were subsequently presented to the Federal Advisory Commission on Electronic Commerce also reflect this viewpoint.[57] Of course, successful implementation of these measures will require substantial cooperation among all affected parties.

f. Telecommunications tax issues. Telecommunications tax structures at the state and local level are based on a public utility tax model designed for the monopoly-based, rate-regulated telephone system that existed in this country for most of the twentieth century. Consequently, the tax burdens placed on telecommunications service providers and consumers have historically been more complex and more substantial than those placed on providers and consumers of other types of services. However, the breakup of the Bell System, the deregulation of the telecommunications industry, and rapid changes

57. *See infra* Part II.B.2.

in technology over the past two decades have transformed the telecommunications industry into one of the most competitive sectors of the economy and rendered the public utility model obsolete. In light of these developments and, in particular, the fact that different types of entities are offering substantially identical services, the Steering Committee members generally agreed that "telecommunications" should be defined to ensure that competitive neutrality was attained among competing firms and services without regard to historical industry classifications that may no longer be relevant for tax purposes. The Project members also asked how state and local jurisdictions could reform their existing taxes to reduce the tax and compliance costs faced by some service providers.

The Project's review covered transaction taxes on telecommunications, but excluded franchise fees—defined as charges by local governments for use of public "rights-of-way." The Project also deferred discussion of property taxes, 911 fees, TDD fees, and Universal Service Fees, in order to narrow the scope of discussions and improve the likelihood of resolving other telecommunications tax issues. Nevertheless, at the end of the day, the consensus reached by the Project members regarding telecommunications taxes was quite limited. There was general agreement regarding competitive neutrality, as reflected in the following statement:

> The premise of telecommunications tax simplification is that telecommunications providers and services should be taxed similarly to other businesses and services. In light of the changing environment, the existing tax structure originally designed for rate-regulated telecommunications companies needs to be reassessed as it applies to an increasingly competitive industry.[58]

This statement implicates two forms of competitive neutrality: (1) neutrality in the taxation of telecommunications services within the industry and (2) neutrality between the telecommunications industry and "all other commercial businesses." To the extent that ensuring such neutrality had the effect of subjecting some businesses to the more onerous telecommunications tax structure, some Project members preferred to eliminate any special telecommunications taxes and treat all telecommunications services and service providers under

58. *NTA Final Report*, *supra* note 7, at 76.

the general sales tax regime. Others, however, objected to abolishing industry-specific taxes on the grounds that the general sales tax structure already encompasses industry-specific distinctions and industry-specific effective tax rates due to differences in capital structure and different mixes of labor, tangible assets, and intangible assets in creating value in the economy.

Furthermore, the Project was unable to settle on a uniform definition of "telecommunications" for a variety of reasons. Some participants objected to a broad definition because it pulled in too many providers or services and potentially subjected them to nontax regulation and other consequences. Other representatives expressed frustration with the fact that similar services are being taxed differently for historical reasons instead of technological or sound tax policy-based distinctions. Because Project members were unwilling to deal with other issues of reform until agreement was reached on the definitional terms, this failure constituted a substantial impediment to progress on any of the other issues the telecommunications working group identified and hoped to address (e.g., consolidation of state and local taxes, the tax treatment of "bundled" service charges, uniform situsing conventions for telecommunications tax purposes, taxation of prepaid calling cards, and a uniform "telecommunications resale" exemption form).

g. Implementation issues. The Project considered two basic approaches to implementing any of its potential recommendations: federal legislation and cooperative state action.[59] While the Project identified several issues that would need to be considered with regard to each approach, it never specified a preferred means of implementation due to the fact that the Project never agreed on any specific substantive proposal. Nevertheless, it is worth noting that those who supported federal legislation believed that electronic commerce was clearly subject to Congress's Commerce Clause power to regulate interstate commerce and took the position that federal legislation, and federal legislation alone, would result in uniform state implementation of any recommended tax policies impacting electronic commerce.

Those who preferred state cooperative action as a means of im-

59. We discuss the issue of implementation of federal legislation regarding state taxation of electronic commerce—which is the authors' clear preference, *infra* Part III. This section merely summarizes the NTA Project Report's coverage of the issue.

plementing the NTA Project's proposals noted that this method follows the pattern of states' enactment of other uniform state legislation (e.g., the Uniform Commercial Code) and that it appropriately avoids federal intervention and preserves state sovereignty over matters of state tax policy about which the states are better schooled and more sensitive than the federal government. Nevertheless, these individuals also noted that federal intervention *would* be required to relax the dormant Commerce Clause nexus standard enunciated by the Supreme Court for sales and use tax purposes. It was also suggested that a hybrid approach combining federal and state action provided a third alternative approach to implementation. Under such an approach, Congress could approve a multistate compact for adoption by the states, arguably removing constitutional objections to such a compact (e.g., based on its alteration of nexus standards for vendors).

4. Concluding remarks on the potential historical import of the NTA Project

In the end, the Project was unable to reach an agreement on the set of issues it explored that satisfied the concerns of both government and business representatives. The inability to reach agreement may be traced in part to the natural tension that exists in our federal system between state sovereignty and local authority, on the one hand, and the needs of a national marketplace for a subfederal tax regime that is simple, uniform, and easily administered, on the other. As a consequence, the Steering Committee agreed that the Project's Report would be an educational document to provide context for the work of the Project to date, and most participants completed work on the Project Report with the stipulated goal of providing the Report to the ACEC, which had specifically requested it.

After the Project was completed, most of the Project and Steering Committee members turned their focus to the ACEC proceedings. It is clear that the submissions made in response to the ACEC's request for proposals relating to state and local taxation of electronic commerce—many of which were authored by Project participants—relied on the NTA Report to some degree. Moreover, the issues addressed in the proposals submitted to the ACEC[60] closely track the broad categories of issues addressed by the NTA Report, including simplification of sales and use tax administration, both as a general matter and by reference to specific technology-based measures; the redesign or codification of nexus standards, for both sales and use and other types of state and local taxes; and tax policy-grounded proposals to improve telecommunications taxation, sourcing conventions, sales and use tax rates, etc.

B. The Advisory Commission on Electronic Commerce

1. The creation of the Commission and its charge

As we have already noted, Congress joined the debate over state taxation of electronic commerce with its adoption in October 1998 of the ITFA.[61] Besides imposing limited substantive restraints on the states' power to impose taxes on Internet access or to impose "multiple" or "discriminatory taxes" on electronic commerce,[62] ITFA established the ACEC. Congress charged the Commission with conducting a thorough study of federal, state, local, and international taxation of transactions using the Internet and other comparable activities. Among the state tax issues that Congress directed the Commission to study, many of which were currently under consideration by the NTA Project, were (1) an examination of model state legislation that would (a) provide uniform definitions of categories of property, goods, services, or information that are subject to or exempt from sales or use taxes, and (b) ensure that Internet-related services would be treated in a tax-neutral manner relative to other sales; (2) an examination of the effects of taxation (and the absence of taxation) of all interstate sales transactions on retail businesses and on state and local governments, including the efforts of state and local governments to collect sales and use taxes on in-state purchases from out-of-state sellers; and (3) an examination of ways to simplify federal, state, and local taxes on telecommunications services.[63] Congress directed the Commission to prepare a report within eighteen months (by April 2000) reflecting the

60. *See infra* Part II.B.2 for a discussion of ACEC proposals.

61. Pub. L. No. 105-277, §§ 1101-04, 112 Stat. 2681-719 (1998); *see supra* Part II.A.2.

62. *See generally* Hellerstein, *Internet Tax*, *supra* note 1.

63. ITFA § 1102(g)(2).

results of its study, including legislative recommendations.

Although at this writing the Commission's report has yet to be issued, it is doubtful that the report will make any far-reaching recommendations due to the deep political and philosophical divisions among members of the Commission[64] and to the requirement that any recommendation of the Commission command a two-thirds supermajority.[65] Moreover, whatever the report may recommend, it is Congress—not the Commission—that will determine the ultimate fate of the questions addressed by the Commission.[66] Accordingly, the Commission's most important legacy may well be the spate of proposals it stimulated when, in the course of its deliberations, it invited the public to submit proposals for resolving the problems raised by state and local taxation of electronic commerce. These proposals, which embody many of the themes that dominated the NTA Project, are likely to be the starting point for any serious efforts to address these issues in the future in Congress, in state legislatures, and in the National Conference of Commissioners on Uniform State Laws ("NCCUSL").[67] We now

64. The Commission was composed of 19 members, including three representatives from the federal government (the Secretary of Commerce, the Secretary of the Treasury, and the United States Trade Representative); eight representatives from state and local governments (including at least one from a state without a sales tax and one from a state without an income tax); and eight representatives of the electronic commerce industry (including small business), telecommunications carriers, local retail businesses, and consumer groups. The Senate Majority Leader and the Speaker of the House were given the right to appoint five members each and the Senate Minority Leader and the House Minority Leader were given the right to appoint three members each. From the outset, the discussions among the Commission members reflected profound differences in outlook that one observer described as an "ideological circus." John B. Judis, *Taxing Issue*, NEW REPUBLIC, Oct. 11, 1999, at 15 (also availalble online at <http://www.tnr.com/archive/1099/101199/judis/101199.html>).

65. "No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission." ITFA § 1103. This means that 13 of the 19 Commission members, and at least two of the eight business or government representatives must agree to any finding or recommendation for it to be included in the report.

66. Indeed, even before the ACEC completed its work the Senate Budget Committee held a hearing addressed to many of the issues before the Commission. *See Hearing on Internet Taxation in the New Millenium: Hearing Before the Senate Budget Committee*, 106th Cong. (2000) (available online at 2000 WL 128967) [hereinafter *Internet Taxation Hearing*].

67. The Executive Committee of NCCUSL, taking note of the fact that the ACEC had been studying the issues of taxation of the Internet and other remote sellers and that the National Governors' Association (NGA), the National Conference of State Legislatures (NCSL), and others perceived a need for simplification of state and local sales and use taxes, resolved that the NCCUSL President appoint a special committee to (a) review the proposals submitted to the ACEC and identify what role, if any would be appropriate for NCCUSL; (b) coordinate

turn to an examination and analysis of these proposals.

2. Proposals submitted to the ACEC for taxing and not taxing electronic commerce

During the course of its deliberations, the ACEC solicited the submission of proposals directed to the problems raised by the application of state sales tax regimes to Internet-based transactions.[68] The Commission asked those submitting proposals to measure their proposals against the following eighteen criteria, which provide a roadmap to the key issues raised by state taxation of electronic commerce:[69]

Simplification

1. How does this proposal fundamentally simplify the existing system of sales tax collection (Some examples may be: common definitions, single rate per state, clarification of nexus standards, and so forth)?

2. How does this proposal define, distinguish, and propose to tax information, digital goods, and services provided electronically over the Internet?

3. How does this proposal protect against onerous and/or multiple audits?

Taxation

4. Does this proposal impose any taxes on Internet access or new taxes on Internet sales?

5. Does this proposal leave the net tax burden on consumers unchanged? (Does it impose an obligation to pay taxes where such an

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with interested organizations in the process of NCCUSL's work; (c) determine the availability of resources necessary to undertake any drafting project; (d) determine the support for and likelihood of enactment of any uniform act; and (d) recommend a process and, if approved, a schedule to undertake and complete the project. Resolution of the Executive Committee of NCCUSL, Jan. 16, 2000 (on file with authors).

68. ACEC, *Advisory Commission on Electronic Commerce Invites Interested Parties to Submit Plans* (Oct. 15, 1999) <http://www.ecommercecommission.org/releases/acec1015.htm> [hereinafter ACEC Press Release].

69. *Id.* at 1-3.

obligation does not exist today? Does it reduce or increase state and local telecommunication taxes? Does it reduce or increase taxes, licensing fees, or other charges on services designed or used for access to or use of the Internet?)

6. Does the proposal impose any tax, licensing or reporting requirement, collection obligation or other obligation or fee on parties other than those with a physical presence in a particular state or political subdivision?

7. What features of the proposal will impact the revenue base of federal, state, and local governments?

Burden on Sellers

8. Does this proposal remove the financial, logistical, and administrative compliance burdens of sales and use tax collections from sellers? Does the proposal include any special provisions with respect to small, medium-sized, or start-up businesses?

Discrimination

9. Does the proposal treat purchasers of like products or services in as like a manner as possible through the implementation of a policy or system that does not discriminate on the basis of how people buy?

10. Does the proposal discriminate against out-of-state or remote vendors or among different categories of such vendors?

International

11. How does this proposal affect U.S. global competitiveness and the ability of U.S. businesses to compete in a global marketplace?

12. Can this proposal be scaled to the international level?

13. How does this proposal conform to international tax systems, including those that are based on source rather than destination? Is this proposal harmonized with the tax systems of America's trading partners?

Technology

14. Is the proposal technologically feasible utilizing widely available software to enable tax collection? If so, what are the initial costs and the costs for required updates, and who is to bear those costs?

Privacy

15. Does the proposal protect the privacy of purchasers?

Sovereignty/Local Government Autonomy

16. Does this proposal respect the sovereignty of states and Native Americans?

17. How does this proposal treat local governments' autonomy and their ability to raise a greater or lesser amount of revenues depending on the needs and desires of their citizens?

Constitutional[ity]

18. Is the proposal constitutional?[70]

The proposals submitted in response to the Commission's request run the gamut from highly restrictive measures that seem to be motivated more by a general hostility to taxation than by any thoughtful consideration of the particular issues raised by sales taxation of electronic commerce, to utopian visions of a world in which advanced information processing technology coupled with dramatic simplification of the tax system will permit taxes on transactions in electronic commerce to be collected seamlessly with a zero burden on the seller. A comprehensive description and analysis of each of these proposals would exceed even a law review's bounds of tolerance for lengthy articles. Consequently, we shall limit our discussion to a brief description of the essential characteristics of the various categories of proposals that were presented to the ACEC along with our views as to their principal strengths and weaknesses.

We should make it clear from the outset that these categories are not airtight, and a number of proposals fit comfortably in more than

70. *Id.*

one category. Indeed, our primary objective in categorizing these proposals is not to pigeonhole a particular proposal but rather to identify the key organizing principles that are likely to form the basis of future discussion of solutions to the problems raised by state taxation of electronic commerce.

a. Radically restrictive proposals. We view as "radically restrictive" those proposals that would not merely define the terms under which electronic commerce could be taxed (e.g., prescribing minimum nexus standards or simplification requirements) or prohibit taxes on a narrow category of transactions (e.g., Internet access[71]), but rather would ban such taxation altogether as applied to a broad range of transactions. We would place in this category such proposals as the Internet Tax Elimination Act,[72] cosponsored by Representatives Kasich and Boehner of Ohio, and the proposal to prohibit all sales and use taxes on business-to-consumer Internet transactions, advanced by Governor Gilmore of Virginia.[73]

The Internet Tax Elimination Act would prohibit the states and their political subdivisions from imposing "[a]ny sales or use tax on domestic or foreign goods or services acquired through electronic commerce."[74] The definition of "electronic commerce" for these purposes[75] is all-encompassing. It embraces "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Inter-

71. Accordingly, we do not regard ITFA as "radically restrictive" although it is restrictive.

72. H.R. 3252, 106th Cong. (1999), discussed *supra* notes 28-35 and accompanying text.

73. Governor James Gilmore, *No Internet Tax: A Proposal Submitted to the "Policies & Options" Paper of the Advisory Commission on Electronic Commerce* (Nov. 8, 1999) <http://www.ecommercecommission.org/proposal.htm>. *See also* Independence Forum, *Proposal: That the Internet Be Made an International, National, State, and Local Tax-free, Duty-free, and Tariff-free Environment* (Nov. 15, 1999) <http://www.ecommercecommission.org/proposal.htm>; E-Freedom Coalition, *The e-Freedom Coalition's Proposal to the Advisory Commission on Electronic Commerce* (Nov. 15, 1999) <http://www.ecommercecommission.org/proposal.htm>.

74. H.R. 3252, 106th Cong. § 2(b) (1999).

75. The Act is drafted as an amendment to ITFA and thus incorporates all of its definitions.

net access."[76] Consequently, the Act would cut a broad swath of tax immunity across state sales tax regimes. It would presumably immunize from tax not only the typical remote sale (e.g., the purchase of a book from Amazon.com), but also the local purchase of goods and services as long as the transaction was "conducted . . . through Internet access." Thus, a customer presumably could purchase a car tax-free if, after negotiating the deal in the showroom, the dealer directed the customer to a convenient on-premises kiosk where the customer could consummate the transaction (indicating his or her acceptance) "through Internet access" with a click of a mouse.

Other than simplicity, the Internet Tax Elimination Act and kindred proposals have little to offer from the standpoint of sound tax policy. Indeed, a more appropriate name for the Internet Tax Elimination Act would be the "Sales Tax Elimination Act." Only those vendors who failed to steer their sales through an Internet-connected device would still be required to collect sales tax. The result for sales tax revenues would be devastating. Moreover, insofar as bricks-and-mortar retailers continued to collect sales tax, there would be competitive inequalities between vendors of identical products, thus violating the goal of economic neutrality in taxation. As Governor Engler of Michigan testified at a Senate Budget Committee hearing addressed to Internet taxation, "if we gravitate towards a tax system that creates a specific loophole for retailers that use the Internet, we risk creation of a federal policy that favors Internet vendors at the expense of Main Street stores and home town merchants."[77]

b. Moderately restrictive proposals. In contrast to the radically restrictive proposals that would immunize a significant segment of economic activity involving electronic commerce from sales or use tax, several more moderate proposals submitted to the ACEC would impose specifically defined limits on the states' power to tax electronic commerce. For example, Dean Andal, Vice Chairman of the California State Board of Equalization and a member of the ACEC, has proposed a congressionally imposed uniform jurisdictional standard applicable to electronic commerce.[78] The eCommerce Coali-

76. ITFA, Pub. L. No. 105-277, § 1104(3).

77. *Internet Taxation Hearing*, *supra* note 66 (testimony of Michigan Governor John Engler).

78. *See* Dean Andal, *A Uniform Jurisdictional Standard: Applying the Substantial Physical Presence Standard to Electronic Commerce* (Nov. 5, 1999) <http://www.ecommercecommission.org/proposal.htm>.

tion, a broad-based coalition of businesses including Cisco Systems, Inc., Citigroup, Microsoft Corporation, and Wal-Mart Stores, Inc., urged the Commission to recommend congressional legislation requiring and establishing standards for state-initiated simplification of the current sales and use tax system.[79]

From a tax policy perspective, the merits of these more targeted proposals depends on an analysis of their specific terms. Dean Andal's proposal removes some of the uncertainty surrounding the question whether an out-of-state vendor has sufficient nexus in the state to be subject to a sales or use tax collection obligation, and for that reason it should be applauded. However, it does so by erecting *higher* nexus standards than exist under the U.S. Supreme Court's precedents and therefore may be subject to criticism on that ground. Moreover, in the eyes of at least one of the coauthors,[80] the physical-presence standard of nexus that Dean Andal endorses makes little sense from the standpoint of sound tax policy. As for the eCommerce Coalition's endorsement of congressionally guided sales and use tax simplification, we wholeheartedly agree with most other observers that simplification is a worthy goal. The devil, of course, is in the details, both in terms of their substance and implementation, and the eCommerce Coalition understandably left those details to future consideration.

c. Simplification proposals. If there is a theme that unites many of the proposals offered to the ACEC, it is that simplification of the structure of existing state sales and use tax regimes is an essential element of a constructive solution to the problems spawned by state taxation of electronic commerce. Indeed, the eCommerce Coalition's proposal discussed above focuses largely on simplification, as do many of the other proposals.[81] Even those proposals that do not focus primarily

79. *See* eCommerce Coalition, *Simplification of the State and Local Sales and Use Tax System* (Nov. 15, 1999) <http://www.ecommercecommission.org/proposal.htm>.

80. Namely, Professor Hellerstein, whose views on this issue (along with those of 170 other academic tax professionals) are discussed further below. *See infra* note 91 and accompanying text .

81. *See, e.g.*, American Institute of Certified Public Accountants, *Untitled Proposal* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; Wayne Eggert, *Electronic Commerce; Modernization and Sales Tax Simplification Proposal* (Nov. 1, 1999) <http:// www.ecommercecommission.org/proposal.htm>; Thomas A. McGuire, *The Zip Code Tax: A Proposal for Simplified Sales Tax on E-Commerce* (Nov. 10, 1999) <http://www. ecommercecommission.org/proposal.htm>; Charles E. McLure, Jr., *Radical Simplification of*

on simplification typically include simplification as an integral part of their prescription.[82]

There is, of course, a good reason for the emphasis on simplification. It is universally recognized that the existing framework of state and local sales taxation is inordinately complex and imposes enormous burdens on interstate vendors. It is likewise recognized that the advent of electronic commerce has exacerbated these difficulties. Consequently, virtually every proposal for addressing the problems raised by sales and use taxation of electronic commerce—other than those that would bar such taxation altogether—has made significant simplification a cornerstone of its blueprint for change. We join the chorus of those who believe that dramatic simplification and uniformity—in the tax base, the tax rate, and in administration—is a necessity of any meaningful solution to the problem of state sales and use taxation of electronic commerce (and, indeed, to nonelectronic commerce as well).

What separates the various simplification proposals, and what deserves some further comment, are the questions whether simplification should be the result of voluntary state action or congressional mandate and whether the simplification should be linked with a relaxation of *Quill*'s physical presence rule for collection of the use tax by remote sellers. With respect to the first question, we would favor whichever path led most quickly to the desired result. Although we appreciate the states' concerns about congressional action that compromises their sovereignty, we are also skeptical about the states' ability to create a truly simple and uniform system of sales taxation on the basis of the voluntary action of forty-five different state legislatures. One need look no further than adoption and implementation of the Uniform Division of Income for Tax Purposes Act—which has been adopted by only a minority of the states imposing income taxes, whose uniform provisions have been modified by individual states, and which is administered differently from state to state—to know that reliance on voluntary state action to create uniform tax rules is a risky business. While there

State Sales and Use Taxes: The Prerequisite for an Expanded Duty to Collect Use Tax on Remote Sales (visited Mar. 8, 2000) <http://www.ecommercecommission.org./proposal.htm>.

82. *See, e.g.*, Committee on State Taxation, *Proposal Related to the Modification and Simplification of State and Local Sales and Use Taxes to the Advisory Commission on Electronic Commerce* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; David E. Hardesty, *Sales and Use Tax Plan: Creation of the Multistate Tax Service* (Nov. 11, 1999) <http://www.ecommercecommission.org/proposal.htm>; North American Retail Dealers Association, *Proposal Related to Electronic Commerce Taxes* (visited Mar. 8, 2000) <http://www.ecommercecommission. org/proposal.htm>.

may be difficulties in obtaining congressional passage of broad-based legislation prescribing the conditions under which the states may tax electronic commerce, we believe that such legislation, if drafted with appropriate sensitivity to concerns of state sovereignty, would more effectively and expeditiously achieve the goal of uniformity in this domain than would voluntary state action.

As to the second question—whether simplification should be linked to an abandonment of the physical-presence rule of nexus for use tax collection purposes—one of us is on record as favoring both simplification and abandonment of the physical-presence rule as guiding principles for taxation of electronic commerce.[83] However, both of us believe that simplification would be desirable in any event. Indeed, dramatic simplification of the sales and use tax structure could undermine the argument on which the Commerce Clause nexus arguments of remote sellers' rests, namely, that collection of taxes on remote sales is simply too difficult under the present system. Consequently, if there were dramatic simplification of the states' sales and use tax structures, even without the formal relaxation of the physical-presence rule of *Quill*, it is possible that the rule would die a quiet death once its analytical underpinnings were removed.

d. Technology proposals. A number of proposals submitted to the ACEC rely on technology to do the heavy lifting in resolving the problems raised by state taxation of electronic commerce.[84] The com-

83. We describe these principles below, *infra* Part II.3.

84. *See, e.g.*, Robert D. Atkinson & Randolph H. Court, *Internet Taxation: A Software Solution* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; David Polatseck, *Sales Tax Simplification Proposal* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; Alistair Kelman, *The easyClear White Paper* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; Ronald E. Knox, *Proposal to Address Issues of State and Local Taxation of Internet Transactions for the Advisory Commission on Electronic Commerce* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; David Hardesty, *Sales Use Tax Plan: Creation of the Multistate Tax Service* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; William F. Willbrand, Jr., *Sales/Use Tax Settlement System: A Proposal for the Advisory Commission on Electronic Commerce* (visited March 4, 2000) <http://www.ecommercecommission.org/proposal.htm>; Michael O. Leavitt, *Streamlined Sales Tax System for the 21st Century* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>; Sales Tax Clearinghouse, *STC Proposal to the Advisory Commission on Electronic Commerce* (Nov. 12, 1999) <http://www.ecommercecommission.org/proposal.htm>; TaxNet Systems, Inc., *Sales and Use Tax Collection on Interstate Purchases* (Nov. 8, 1999) <http://www.ecommercecommission.

mon theme of these proposals is that the software technology exists (or will soon exist) that will seamlessly integrate the tax payment process into the electronic commerce transaction. As one of the proposals baldly puts it, "Merchant Swipes Card-Tax is Electronically Paid."[85] These proposals also promise to perform this function at a moderate cost, or at least at a cost that will be borne by the taxing authority rather than by the merchant.[86]

We are very hopeful that these proposals can in fact deliver what they promise. If they can, they will play an essential role, along with simplification, in paving the way towards a workable solution to the problem of taxing electronic commerce. For the moment, however, we believe it is worth keeping in mind that if wishes were horses then beggars would ride. Unless and until it can be demonstrated that technology exists that is capable, among other things, of determining the appropriate taxing authority, determining the taxability of the particular purchase or purchaser, processing this information on a real time basis and seamlessly integrating it with the credit card or other payment mechanism, and doing all this at a reasonable cost, we must remain cautious—but nonetheless hopeful—about the ability of technology to resolve or help resolve the problems of taxing electronic commerce.

e. Origin-based proposals. Some observers have suggested that the solution to the problem of taxing electronic commerce lies in reconfiguring the sales tax as an origin-based tax rather than a destination-based tax.[87] According to supporters of these origin-based proposals, their beauty lies in their ability to cope with two of the key problems facing the existing destination-based system: identification of the state of the purchaser and, once that state has been identified, establishing nexus over the seller in that state so that the seller can be required to

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org/proposal.htm>; Taxware International Inc., *Adapting Tax Technology to the Internet—the eCommerce Transaction Tax Server* (Nov. 12, 1999) <http://www.ecommercecommission.org/proposal.htm>.

85. TaxNet Systems, Inc., *Sales and Use Tax Collection on Interstate Purchases* (Nov. 8,1999) <http://www.ecommercecommission.org/proposal.htm>.

86. *See, e.g.*, National Governors Association et al., *Streamlined Sales Tax System for the 21st Century* (visited Mar. 8, 2000) <http://www.ecommercecommission.org/proposal.htm>.

87. *See* Andrew Wagner & Wade Anderson, *Proposal of an Origin Based Tax Solution for the Possible Taxation of Digitized Products Sold Over the Internet* (Nov. 8, 1999) <http://www.ecommercecommission.org/proposal.htm>; *see also Debate: NGA's Shafroth, Heritage's Thierer on "Streamlined" Proposal, Origin-Basing for E-Commerce*, 18 ST. TAX NOTES 279 (2000); Terry Ryan & Eric Miethke, *The Seller-State Option: Solving the Electronic Commerce Dilemma*, 15 ST. TAX NOTES 881 (1988).

collect the tax. Under an origin-based system, there is no need to identify the state of the purchaser and there will always be nexus in the taxing state where the seller is located.

Notwithstanding the apparent elegance and simplicity of an origin-based sales tax, it suffers from several fundamental defects. First, an origin-based sales tax is inconsistent with the basic philosophy underlying the sales tax as a levy on consumption rather than production. Transforming the sales tax from a tax imposed by the state of the consumption of goods and services to a tax imposed by the state of the production of goods and services effectively transforms the sales tax into a different type of levy conceptually and economically. For this reason, it creates a second fundamental difficulty, namely, a "race to the bottom," as vendors of goods and services shift their sources of production to states with no or low sales taxes. Thus, while source-based taxes may appear attractive from an administrative standpoint, "in an open economy, avoidance through the mobility of capital could be so great that there would be little remaining base to administer."[88]

Despite these objections to an origin-based sales tax, it could well provide a useful mechanism for dealing with the most difficult problem raised by electronic commerce, namely, the sale of digital products to consumers.[89] In this context, the compliance costs of administering a destination-based system may be so great that "[t]he administrative costs of conceptual rigor are too great."[90] Accordingly, one should not rule out the use of an origin-based sales tax if employed selectively in circumstances under which a destination-based sales tax cannot be administered at acceptable costs.

88. William F. Fox & Matthew N. Murray, *The Sales Tax and Electronic Commerce: So What's New?*, 50 NAT'L TAX J. 573, 575 (1997).

89. In our judgment, administering a destination-based sales tax system for the sale of tangible products, whose destination can ordinarily be determined, and for sales to businesses, who frequently self-assess use taxes and whose purchases are often audited, poses less daunting problems than administering such a system with respect to sales of digital products to consumers. Indeed, at least some of the origin-based proposals are limited to sales of digital products. *See* Wagner & Anderson, *supra* note 87.

90. Encyclopaedia Britannica v. Commissioner of Internal Revenue, 685 F.2d 212, 217 (7th Cir. 1982) (Posner, J.).

3. Concluding thoughts on the ACEC proposals and guiding principles for taxation of electronic commerce

The proposals submitted to the ACEC, like the various proposals that were examined during the NTA Project, contain much food for thought that will take some time to digest. For the immediate future, we believe the most pressing matter, which will likely determine whether there is meaningful progress towards a broad-based solution to the problems raised by state taxation of electronic commerce, is the endorsement, by a majority of concerned parties, of a set of principles to govern future deliberations in this domain. We believe that a worthy effort in this direction has already been undertaken. Over 170 academic tax policy specialists—economists and professors of tax law (including two winners of the Nobel Prize in Economics)—have endorsed an "Appeal for Fair and Equal Taxation of Electronic Commerce." This appeal sets forth four general principles that should guide any effort to deal with sales and use taxation of electronic commerce.[91] These principles are:

> 1. Electronic commerce should not permanently be treated differently from other commerce. There is no principled reason for a permanent exemption for electronic commerce. Electronic commerce should be taxed neither more nor less heavily than other commerce.
>
> 2. Remote sales, including electronic commerce, should, to the extent possible, be taxed by the state of destination of sales, regardless of whether the vendor has a physical presence in the state. In limited cases, where it is impossible to determine the destination of sales of digital content to households, it may be necessary to substitute a surrogate system. In no case should taxation of remote electronic commerce be limited to origin-based taxation, which would induce a "race to the bottom" and, in effect, no taxation at all.
>
> 3. There must be enough simplification of sales and use taxes to make destination-based taxation of sales feasible. Such simplification might include, for example, unification of the tax base across states, unification of tax rates within states, and/or sourcing of sales

91. *State Sales and Use Taxation of Electronic Commerce: Simplification is Needed; A Statutory Exemption is Not: Testimony Before the Senate Budget Committee*, 106th Cong. (2000) (testimony of Charles E. McLure, Jr., Hoover Institution Stanford University)

only to the state level, as well as simplification of administrative procedures.

4. A means must be found to eliminate burdens of compliance on sellers making only small amounts of sales in a state. These might include software-based systems made available at state expense, more realistic vendor discounts, and/or de minimis rules.[92]

III. FEDERAL CONSTITUTIONAL RESTRAINTS ON CONGRESSIONAL POWER TO LEGISLATE REGARDING STATE TAXATION OF ELECTRONIC COMMERCE

On the assumption that any broad-based solution to the problems raised by state taxation of electronic commerce will require congressional action (whether in the form of federal legislation or congressional consent to a state compact),[93] the question we explore here is whether there are federal constitutional restraints that might limit Congress's ability to resolve these issues.[94] Any effort to design a solution to the problems raised by state taxation of electronic commerce will almost certainly require congressional action of some kind. As noted above, most of the proposals for reform in this area have suggested that the states should be required to adopt uniform definitions of goods and services in taxing or exempting goods and services sold in electronic commerce and to impose only one rate per state.[95] It is difficult to imagine that this result can be achieved without congressional legislation.[96] Similarly, many observers believe that any sensible ap-

92. *Id.* The academic coauthor of this article, who is a signatory of the statement, wholeheartedly agrees with all of these principles. The nonacademic coauthor, while generally sympathetic to these principles, does not wholeheartedly agree with all of them.

93. We recognize that there are some that might challenge this assumption, but, for the reasons suggested below, we believe the assumption is a reasonable one.

94. The following discussion draws freely from Walter Hellerstein, *Federal Constitutional Limitations on State Taxation to Legislate Regarding State Taxation of Electronic Commerce*, NAT'L TAX J. (forthcoming 2000).

95. *See supra* Part II; *see also* Walter Hellerstein, *State Taxation of Electronic Commerce*, 52 TAX. L. REV. 425 (1997); Charles E. McLure, Jr., *Electronic Commerce and the Tax Assignment Problem: Preserving State Sovereignty in a Digital World*, 14 ST. TAX NOTES 1169 (1998); Traci G. Wright & Jesse Rothstein, *Taxes and the Internet: Updating Tax Structures for a Wired World*, 17 ST. TAX NOTES 491 (1999).

96. The suggestion that the states can achieve this goal through voluntary efforts is, in our view, unrealistic. One need look no further than our experience under the Multistate Tax Com-

proach to taxation of electronic commerce must modify the rule of *Quill Corp. v. North Dakota*,[97] that out-of-state vendors without physical presence in the state may not be compelled to collect use taxes on sales to local consumers, regardless of the nature or extent of their sales into the state.[98] Congressional action will clearly be required to alter the rule of *Quill*.

A. Commerce Clause Considerations

The question whether Congress possesses power under the Commerce Clause to provide a comprehensive solution to the problem of state taxation of electronic commerce is, at first glance, an easy one. The Constitution grants Congress the power "[t]o regulate commerce . . . among the several States."[99] The Supreme Court has interpreted that power in sweeping terms. Thus in the *Shreveport Rate Case*,[100] which sustained Congress's power to regulate local rates because they affected interstate rates, the Court declared:

> It is unnecessary to repeat what has frequently been said by this court with respect to the complete and paramount character of the power confided to Congress to regulate commerce among the several States. It is of the essence of this power that, where it exists, it dominates. . . . By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control.[101]

The Court has also sustained the legislation in the following areas as legitimate exercises of Congress's power to regulate interstate com-

pact, which is designed to "promote uniformity or compatibility in significant components of tax systems" to justify such skepticism. Only about half the states have joined the Compact, although a number of others are associate members. Jerome R. Hellerstein & Walter Hellerstein, STATE AND LOCAL TAXATION: CASES AND MATERIALS 566 (6th ed. 1997). Moreover, in implementing the Uniform Division of Income for Tax Purposes Act ("UDITPA"), which is embodied in the Compact, many states have adopted their own variations on the statute, *id.* at 567-69, thereby undermining the consistency that the Compact and the statute were designed to promote. Moreover, the states differ in the extent to which they have adopted the Multistate Tax Commission's regulations interpreting UDITPA. *Id.*

97. 504 U.S. 298 (1992).

98. *See supra* note 95.

99. U.S. CONST. art. I, § 8, cl. 3.

100. Houston E&W Tex. Ry. v. United States, 234 U.S. 342 (1914).

101. *Id.* at 350-51.

merce: (1) the amount of wheat a farmer can grow for his own consumption;[102] (2) discriminatory practices in local hotels and restaurants;[103] and (3) local criminal activity.[104]

Furthermore, Congress's authority not only to restrict but also to expand state power to tax or regulate interstate commerce, by comparison to the restraints on such power that would otherwise exist under the so-called "dormant" Commerce Clause in the absence of congressional legislation, is well settled. Thus in *Prudential Insurance Co. v. Benjamin*,[105] the Court sustained a South Carolina insurance premiums tax imposed solely on foreign insurance companies—a levy that clearly would have been struck down under the Commerce Clause if Congress had not consented to such legislation in the McCarran-Ferguson Act. In so holding, the Court declared:

> The power of Congress over commerce exercised entirely without reference to coordinated actions of the states is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons.[106]

From the foregoing, one might reasonably conclude that there could be no serious objection to Congress's exercise of its power under the Commerce Clause to forge a comprehensive solution to the problems raised by state taxation of electronic commerce. Because it has plenary power over the channels of interstate commerce, "Congress may keep the way open, confine it broadly or closely, or close it entirely, subject only to the [limitations]"[107] that the Constitution imposes on Congress's own power. Indeed, in *Moorman Manufacturing Co. v. Bair*,[108] the Court explicitly indicated that Congress possesses power to legislate uniform state tax rules among the states—a subject

102. *See* Wickard v. Filburn, 317 U.S. 111 (1942).

103. *See* Katzenbach v. McClung, 379 U.S. 294 (1964); Heart of Atlanta Motel v. United States, 379 U.S. 241 (1964).

104. *See* Perez v. United States, 402 U.S. 146 (1971).

105. 328 U.S. 408 (1946).

106. *Id.* at 434 (footnote omitted).

107. *Id.*

108. 437 U.S. 267, 280 (1978).

of particular relevance to any legislative solution to the problems raised by sales and use taxation of electronic commerce. Thus, the Court observed that "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income."[109]

Moreover, it is equally clear that Congress may consent to state legislation that would be an integral part of a rational solution to the problem of taxing electronic commerce, even if such legislation would be unconstitutional under the dormant Commerce Clause in the absence of such consent.[110] As the Court observed in *Quill* itself, which reaffirmed the dormant Commerce Clause principle that the physical presence of an out-of state vendor is an essential prerequisite of a state's power to require the vendor to collect the state's use tax, "Congress is . . . free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[111]

1. Recent decisions invalidating congressional exercises of the Commerce Power

Despite Congress's broad authority under the Commerce Clause to legislate in the domain of state taxation, one might argue that some of the Court's more recent opinions reflect a less expansive view of congressional power to restrict state action and that they require rethinking of the position articulated above.[112] Specifically, in *United States v. Lopez*,[113] the Court held that Congress lacks power under the Commerce Clause to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce. And in *Printz v. United States*,[114] the Court held that Congress lacks the power under the Commerce Clause to require state officials to conduct background checks on prospective gun purchasers under the Brady Handgun Violence Protection Act. Do these decisions

109. *Id.*

110. *See supra* notes 108-09 and accompanying text.

111. Quill Corp. v. North Dakota, 504 U.S. 298, 318 (1992).

112. Indeed, such an argument has been advanced. *See* Richard D. Nicholson, *Preemption of State Sales and Use Taxes on Goods Purchased Over the Internet: An Unconstitutional Mission*, 18 ST. TAX NOTES 213 (2000).

113. 514 U.S. 549 (1995).

114. 521 U.S. 898 (1997).

seriously inhibit Congress in its ability to fashion a solution to the problems raised by state taxation of electronic commerce? In our judgment, the answer to this question is no, although they do suggest that certain forms of congressional action would lie outside Congress's commerce power.

a. United States v. Lopez. In *Lopez*, even though the Court invalidated the Gun-Free School Zones Act of 1990, it did so in an opinion that reaffirmed, rather than discredited, the essential contours of the Court's affirmative Commerce Clause doctrine. Thus the Court, after summarizing the "era of Commerce Clause jurisprudence that greatly expanded the previously defined authority of Congress under that Clause,"[115] identified "three broad categories of activity that Congress may regulate under its commerce power."[116]

> First, Congress may regulate the use of the channels of interstate commerce. Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come only from intrastate activities. Finally, Congress' commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce, *i.e.*, those activities that substantially affect interstate commerce.[117]

The Court found that the Gun-Free School Zones Act of 1990 fell within none of these categories. It clearly was not a regulation of the use of the channels of interstate commerce nor was it an attempt to prohibit the interstate transportation of a commodity through the channels of commerce. The only close question, in the Court's opinion, was whether the activity that Congress sought to regulate "substantially affects" interstate commerce. Here, too, the Court concluded that the legislation fell outside of even its most expansive precedents—including those involving regulation of intrastate coal mining, intrastate extortionate credit transactions, restaurants using substantial interstate supplies, inns and motels catering to interstate guests, and production and consumption of homegrown wheat.[118] The Gun-Free School

115. *Lopez*, 514 U.S. at 556.
116. *Id.* at 558.
117. *Id.* at 558-59 (citations omitted).
118. *See id.* at 559-60. *See also supra* notes 101-05 and accompanying text.

Zones Act, by contrast, "has nothing to do with 'commerce' or any sort of economic enterprise, however broadly one might define those terms."[119] Nor was there any "jurisdictional element"[120] that would ensure that the firearm in question affected interstate commerce (i.e., there was no requirement in the statute that the guns banned from the school zone be shipped or transported in interstate commerce).

In short, "[t]he possession of a gun in a local school zone is in no sense an economic activity that might . . . substantially affect any sort of interstate commerce."[121] In the Court's view, "[t]o uphold the Government's contentions here, we would have to pile inference upon inference in a manner that would bid fair to convert congressional authority under the Commerce Clause to a general police power of the sort retained by the States."[122]

Lopez does not impose significant restraints on Congress's power under the Commerce Clause to legislate regarding state taxation of electronic commerce. One cannot seriously maintain that electronic commerce does not "substantially affect" interstate commerce within the meaning of the precedents that the Court explicitly reaffirmed in *Lopez*. Indeed, if, as the Court reiterated, such activities as intrastate extortionate credit transactions, restaurants using substantial interstate supplies, inns and motels catering to interstate guests, and production and consumption of homegrown wheat "substantially affect" interstate commerce, electronic commerce would appear to be a "lesser included offense." Moreover, one could clearly draft congressional legislation as a regulation of the channels of interstate commerce—the Internet—that would fall squarely within another well-accepted basis for the exercise of the congressional commerce power.

b. Printz v. United States. In *Printz*, the Court held that certain provisions of the Brady Handgun Violence Prevention Act commanding state and local law enforcement officers to conduct background checks on prospective handgun purchasers exceeded Congress's authority. In contrast to *Lopez*, the focus of the controversy in *Printz* was not whether regulation of the activity in question—the distribution of firearms—fell within the scope of Congress's power to regulate interstate commerce. Indeed, the Court did not appear to

119. *Lopez*, 514 U.S. at 561.
120. *Id.*
121. *Id.* at 567.
122. *Id.*

take issue with the dissent's observation that "there can be no question that the [Commerce Clause] adequately supports the regulation of commerce in handguns effected by the Brady Act."[123]

Instead, the key issue in *Printz* was whether state and local law enforcement officers could be required to implement a federal regulatory regime. The Court in *Printz*, gave an unequivocally negative answer to this question:

> The Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program. It matters not whether policymaking is involved, and no case-by-case weighing of the burdens or benefits is necessary; such commands are fundamentally incompatible with our constitutional system of dual sovereignty.[124]

What implications does this holding have on congressional power to enact legislation affecting state taxation of electronic commerce? First, it clearly indicates that Congress may not rely on state and local tax personnel to administer a federal regulatory scheme directed to state taxation of electronic commerce. Up to now, discussions of alternative federal legislative solutions to the problems raised by state taxation of electronic commerce have not seriously entertained the possibility of enlisting state and local personnel to implement a federal regulatory regime. *Printz* makes it clear that any such proposal would be dead on arrival from a constitutional standpoint, and we should not waste our time even considering any such proposal.

Second, *Printz* does not appear to jeopardize the constitutionality of the type of legislation that has been suggested in connection with state taxation of electronic commerce. For example, Congress could presumably enact a statute forbidding the states from imposing sales and use taxes on electronic commerce unless they (1) limited their tax to one rate per state, (2) adopted uniform definitions of taxable and nontaxable items prescribed by Congress, (3) simplified their administrative procedures for collecting taxes in ways specified by Congress, and (4) compelled out-of-state vendors to collect taxes only if their in-state sales exceeded de minimis levels. At the same time, Congress

123. Printz v. United States, 521 U.S. 898, 941 (1997) (Stevens, J., dissenting).

124. *Id.* at 935.

could permit the states to require remote vendors to collect such taxes regardless of the physical presence of the out-of-state vendor in the state.

Legislation of this nature falls squarely within the traditional form of congressional Commerce Clause legislation limiting or consenting to state taxation. It would prescribe the conditions under which the states can tax particular activities in interstate commerce, just as it has done in Public Law 86-272,[125] which limits the states' power to tax income from interstate commerce, and more recently in the ITFA,[126] which limits the states' power to tax certain forms of electronic commerce.[127] And it would consent to the taxation of interstate commerce, just as it has done with respect to state taxation of the insurance industry.[128] There is nothing in *Printz* that casts any doubt on the constitutionality of such legislation, because such legislation does not "compel the States to enact or administer a federal regulatory program."[129]

c. Reno v. Condon. The Court's recent decision in *Reno v. Condon*,[130] which sustained Congress's power under the Commerce Clause to enact the Driver's Privacy Protection Act of 1994 (DPPA), reinforces the foregoing reading of *Lopez* and *Printz*. The DPPA arose out of Congress's concern that many states that routinely require drivers

125. 15 U.S.C. § 381 (1994).

126. ITFA, Pub. L. No. 105-277, §§ 1101-04, 112 Stat. 2681-719 (1998); *see generally* Hellerstein, *Internet Tax*, *supra* note 1.

127. Over the years, Congress has exercised its commerce power to limit state tax power in a number of contexts. In adopting the Railroad Revitalization and Regulatory Reform Act of 1975, Pub. L. No. 94-210, 90 Stat. 54, 49 U.S.C. § 11501 (Supp. III 1997), Congress prohibited the states from taxing railroad property more heavily than other commercial and industrial property. Congress subsequently extended similar protection to motor carriers and to air carriers. *See* 49 U.S.C. § 14502 (Supp. III 1997); 49 U.S.C. § 40116 (1994). In amending the securities acts in 1975, Congress imposed limitations on the power of states to levy stock transfer taxes. *See* Pub. L. No. 94-29, 89 Stat. 97, 15 U.S.C. § 78bb(d) (1994). Federal legislation also prohibits the states from imposing user charges in connection with the carriage of persons in air commerce, 49 U.S.C. § 40116(b) (1994); it "supersede[s] any and all State taxes insofar as they now or hereafter relate to any employee benefit plan" instituted pursuant to the Employee Retirement Income Security Act, 29 U.S.C. § 1144(a) (1994); it prohibits the states from imposing electrical energy taxes discriminating against out-of-state purchasers, 15 U.S.C. § 391 (1994); it prohibits localities from taxing providers of direct-to-home satellite services, Pub. L. No. 104-104, tit. VI, § 602, 47 U.S.C. § 151 (Supp. III 1997); and it prohibits state and local governments from taxing flights of commercial aircraft or any activity or service aboard such aircraft unless the aircraft takes off or lands in the taxing jurisdiction, 49 U.S.C. § 40116(c) (1994).

128. See *supra* notes 106-07 and accompanying text.

129. *Printz*, 521 U.S. at 933 (quoting New York v. United States, 505 U.S. 144, 188 (1992)).

130. 120 S. Ct. 666 (2000).

and automobile owners to furnish personal information to state motor vehicle departments had been selling this personal information to individuals and businesses. In adopting the DPPA, Congress regulated the disclosure of such personal information. Among other things, the DPPA established a regulatory scheme that restricted the states' ability to disclose a driver's personal information without the driver's consent. Personal information was defined as "any information 'that identifies an individual, [with an exception for] information on vehicular accidents, driving violations, and driver's status.' "[131] The DPPA's ban did not apply to drivers who consented to release of their data, and the Act established rules governing how such consent could lawfully be obtained. The DPPA also contained a number of exceptions to the prohibition against nonconsensual disclosures.

South Carolina challenged the constitutionality of the DPPA as "incompatible with the principles of federalism."[132] The Court first addressed the claim that Congress lacked the authority under the Commerce Clause to enact the DPPA. Relying on its opinion in *Lopez*, where it had identified three broad categories of activity that Congress could regulate under its commerce power,[133] the Court found that the personal information that the DPPA regulates fell within the second category of activity that Congress could regulate under its commerce power—"things in interstate commerce."[134]

The Court observed that the personal information that the states have historically sold was used by insurers, direct marketers, and others engaged in interstate commerce to contact drivers with customized solicitations. The information was also used in the stream of commerce by various public and private entities for matters related to interstate commerce. Accordingly, the Court concluded: "Because drivers' information is, in this context, an article of commerce, its sale or release into the interstate stream of business is sufficient to support congressional regulation."[135]

The *Condon* Court's treatment of *Lopez* supports the view that *Lopez* is no obstacle to congressional legislation regulating state taxation

131. *Id.* at 668-69 (quoting the DPPA).

132. *Id.* at 670.

133. *See supra* text accompanying note 117.

134. *Condon*, 120 S. Ct. at 671.

135. *Id.*

of electronic commerce. Since electronic commerce invariably involves an "article of commerce" (e.g., the purchase and/or transfer of a digital or nondigital product over the Internet), there can be no question that "its sale or release into the interstate stream of business is sufficient to support congressional regulation." *Lopez* is therefore no more an obstacle to congressional legislation limiting state taxation of electronic commerce than it was an obstacle in *Condon* to congressional legislation limiting state sale of personal information in interstate commerce.

The fact that Congress possessed legislative authority over the subject matter of the DPPA did not end the dispute in *Condon*. In *Printz*, the Court held the Brady Handgun Prevention Act invalid *not* because Congress lacked authority over commerce in handguns but rather because the Tenth Amendment and principles of federalism preclude the federal government from "issu[ing] directives requiring the States to address particular problems"[136] or "command[ing] the States' officers . . . to administer or enforce a federal regulatory program."[137] South Carolina claimed that this is exactly what the federal government had done in the DPPA by thrusting upon the states the day-to-day responsibility for administering its complex provisions and thereby making state officials unwilling instruments of federal policy. Specifically, South Carolina complained that the DPPA required its employees to learn and apply the Act's substantive provisions and that this would consume the employees' time and the state's resources.

But the Court disagreed. While acknowledging that the DPPA might require time and effort on the part of state employees, the Court concluded that the case was governed not by *Printz* but by *South Carolina v. Baker*,[138] which sustained Congress's power to enact legislation that prohibited the states from issuing unregistered bonds. The Court declared:

> Like the statute at issue in *Baker*, the DPPA does not require the States in their sovereign capacity to regulate their own citizens. The DPPA regulates the States as the owners of databases. It does not require the South Carolina Legislature to enact any laws or regulations, and it does not require state officials to assist in the enforcement of federal statutes regulating private individuals.[139]

136. Printz v. United States, 521 U.S. 898, 935 (1997).
137. *Id.*
138. 485 U.S. 505 (1988).
139. *Condon*, 120 S. Ct. at 672.

The Court's decision in *Condon* reaffirms the conclusion that *Printz* does not constitute a significant limitation on federal legislation directed to state taxation of electronic commerce. As noted above,[140] the type of federal legislation that has been suggested in connection with state taxation of electronic commerce does not "require the States in their sovereign capacity to regulate their own citizens," "to enact any laws or regulations," or to "require state officials to assist in the enforcement of federal statutes regulating private individuals." Rather it would simply forbid the states from taxing electronic commerce unless they complied with congressionally prescribed conditions, a traditional form of federal legislation that lies outside the purview of *Printz*.[141]

2. Eleventh Amendment limitations on Congress's power to legislate under the Commerce Clause

The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."[142] In a series of recent cases, the Supreme Court has read the Eleventh Amendment's bar against suits in federal court by nonresidents against nonconsenting states as reflecting a broad, constitutionally-based principle of state sovereign immunity that Congress may not override through the exercise of its power under the Commerce Clause and other constitutional grants of congressional power. In *Seminole Tribe of Florida v. Florida*,[143] the question was whether Congress, through the exercise of its commerce power, could authorize suits in federal court by Indian tribes against states that had not consented to such suits. In answering that question in the negative, the Court observed that "[f]or over a century we have reaffirmed that federal jurisdiction over suits against unconsenting States 'was not contemplated by the Constitution when establishing

140. *See supra* notes 124-29 and accompanying text.

141. As the Court declared in *New York v. United States*, 505 U.S. 144, 167 (1992): "[W]here Congress has the authority to regulate private activity under the Commerce Clause, we have recognized Congress's power to offer States the choice of regulating that activity according to federal standards or having state law pre-empted by federal regulation." *Id.*

142. U.S. CONST. amend XI.

143. 517 U.S. 44 (1996).

the judicial power of the United States.' "[144] Moreover, even though the Court had held just six years earlier that Congress could, through the exercise of its commerce power, override the states' Eleventh Amendment immunity and create federal jurisdiction over suits against unconsenting states,[145] the Court in *Seminole* overruled this decision in concluding that Congress lacked such power. The Court declared:

> [T]oday, we reconfirm that the background principle of state sovereign immunity embodied in the Eleventh Amendment is not so ephemeral as to dissipate when the subject of the suit is an area, like the regulation of Indian commerce, that is under the exclusive control of the Federal Government. Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against unconsenting States.[146]

The Court reaffirmed and expanded the teaching of *Seminole* in three decisions handed down in 1999. In *Florida Prepaid Postsecondary Education Expense Board v. College Savings Bank ("Florida Prepaid")*,[147] the Court held that Congress could not constitutionally abrogate the states' Eleventh Amendment immunity from claims of patent infringement in federal court. Tracking its reasoning in *Seminole*, the Court held that neither the Commerce Clause nor the Patent Clause (nor any other power granted to Congress under Article I of the Constitution) provided a basis for overriding state sovereign immunity embodied in the Eleventh Amendment.

The Court recognized in *Florida Prepaid* (as it had in *Seminole*) that Congress retains the authority to abrogate state sovereign immunity pursuant to the Fourteenth Amendment because "the Fourteenth Amendment, by expanding federal power at the expense of state autonomy, had fundamentally altered the balance of state and federal power struck by the Constitution."[148] Nevertheless, the Court determined that the Fourteenth Amendment's authorization for "appropriate legislation" to protect against deprivations of property without due process of law did not provide Congress with authority to abrogate

144. *Id.* at 54 (citation omitted).

145. *See* Pennsylvania v. Union Gas Co., 491 U.S. 1 (1989).

146. *Seminole*, 517 U.S. at 72.

147. 119 S. Ct. 2199 (1999).

148. *Id.* at 2205 (quoting *Seminole*, 517 U.S. at 59).

state sovereign immunity, because there was nothing in the legislative record to suggest that state patent infringement had caused " 'widespread and persisting deprivation of constitutional rights' of the sort Congress has faced in enacting proper prophylactic § 5 legislation."[149]

College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board ("*College Savings*"),[150] a companion case to *Florida Prepaid*, involved a suit against a state instrumentality for allegedly engaging in unfair competition in violation of the Lanham Act. The Court reiterated that Congress's Article I powers (here an amendment to the Lanham Act) were insufficient to override state sovereign immunity; it found the Fourteenth Amendment equally unavailing as a basis for abrogating the states' Eleventh Amendment immunity because there was no deprivation of any property at issue; and it overruled *Parden v. Terminal Railway*,[151] which held that a state, by engaging in activities that Congress had regulated under the Commerce Clause, was deemed to waive its Eleventh Amendment immunity to suit in federal court. Rejecting the "constructive-waiver experiment of *Parden*" as "ill conceived,"[152] the Court declared that a state waiver of sovereign immunity, like the waiver of any other constitutional right, must be an "intentional relinquishment or abandonment of a known right or privilege."[153]

In *Alden v. Maine*,[154] the third of the 1999 trilogy of state sovereign immunity cases, the Court held that Congress lacks the power under Article I of the Constitution to subject nonconsenting states to private suits for damages in *state* courts. The petitioners in the case, state probation officers, had sued Maine for a violating the federal Fair Labor Standards Act in federal court. Because Maine had not consented to such suit, the federal district court dismissed the suit on the basis of *Seminole*. The Court concluded that the states' immunity from suit is a fundamental aspect of the sovereignty they enjoyed before the adoption of the Constitution, and that they retained such immunity except as altered by the Constitution or its amendments. The Court

149. *Id.* at 2202.
150. *Id.* at 2219.
151. 377 U.S. 184 (1964).
152. *College Savings*, 119 S. Ct. at 2228.
153. *Id.* at 2229 (citation omitted).
154. *Id.* at 2240 (1999).

further concluded, based on an analysis of history, precedent, and the structure of the Constitution, that Article I of the Constitution had not granted Congress the power to abrogate states' immunity from private suits in their own courts. The consequence of the Court's decision in *Alden* was that the probation officers were barred from suing Maine in *either* federal *or* state court, despite a federal statute providing them with substantive protections under the Fair Labor Standards Act.

The Court observed that its holding in *Alden*—that the state officers could not sue the state in either federal or state court to vindicate their rights under federal law—"does not confer upon the State a concomitant right to disregard the Constitution or valid federal law."[155] The Court further noted that sovereign immunity did not bar all judicial review of state compliance with the Constitution: first, many states have enacted statutes consenting to suit and thus waiving sovereign immunity; second, the United States (as distinguished from private litigants) may bring a suit against nonconsenting states to assure the vindication of federal rights in federal and state courts; third, the adoption of the Fourteenth Amendment required the states to surrender a portion of their immunity from suit (at least when rights protected by that amendment are at stake); fourth, the principle of state immunity does not extend to lesser entities (e.g., municipalities or other governmental entities that are not arms of the state); and, fifth, sovereign immunity does not bar suit against state officers for injunctive or declaratory relief in state or federal courts.[156] These caveats to the contrary notwithstanding, it is plain that *Alden* (along with *Seminole*, *Florida Prepaid*, and *College Savings*) has significantly limited Congress's power to subject unwilling states to suit in federal or state court.

Finally, in its most recent foray into state sovereign immunity and the Eleventh Amendment, the Court held that Congress lacked the power under section 5 of the Fourteenth Amendment to abrogate the states' immunity from suit in federal court in actions brought against states for violation of the Age Discrimination in Employment Act of 1967.[157] The Court reaffirmed its commitment to the principles articulated in *Seminole* and the trilogy of 1999 cases that Congress lacks the power under the Commerce Clause to abrogate state sovereign immunity and that Congress may not abrogate state sovereign immu-

155. *Id.* at 2266.

156. *See* General Oil Co. v. Crain, 209 U.S. 211 (1908).

157. *See* Kimel v. Florida Bd. of Regents, 120 S. Ct. 631 (2000).

nity under the enforcement provision of the Fourteenth Amendment unless such legislation is "appropriate legislation" to remedy substantive violations of the amendment. In order for legislation to satisfy the latter standard, "[t]here must be a congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end."[158]

Applying this "congruence and proportionality test," the Court concluded that the Age Discrimination in Employment Act was not "appropriate legislation" under section 5 of the Fourteenth Amendment. First, the Court observed that age discrimination violates the Equal Protection Clause of the Fourteenth Amendment only if it is unrelated to a legitimate state interest and that it had in fact rejected claims that age discrimination violated the Equal Protection Clause on three separate occasions. Hence, the ADEA's broad bar against all age discrimination "prohibits substantially more state employment decisions and practices than would likely be held unconstitutional under the applicable equal protection, rational basis standard."[159] Second, the Court found little evidence that states were in fact engaged in age discrimination and that "Congress's 1974 extension of the Act to the States was an unwarranted response to a perhaps inconsequential problem."[160] Accordingly, the Court concluded that "[i]n light of the indiscriminate scope of the Act's substantive requirements, and the lack of evidence of widespread and unconstitutional age discrimination, . . . the ADEA is not a valid exercise of Congress's power under § 5 of the Fourteenth Amendment."[161] The ADEA's purported abrogation of the states' sovereign immunity was therefore invalid.

What are the implications of all this for congressional legislation directed to state taxation of electronic commerce? First, it is apparent that these decisions deprive Congress of the power to create a federal

158. City of Boerne v. Flores, 521 U.S. 507, 520 (1997).

159. *Kimel*, 120 S. Ct. at 647.

160. *Id.* at 649.

161. *Id.* at 650. It is worth noting that the Court's conclusion that Congress lacked the power under section 5 of the Fourteenth Amendment to extend the provisions of the ADEA to the states did not overrule its earlier determination that Congress possessed power under the Commerce Clause to extend the ADEA's provisions to the states. *See* EEOC v. Wyoming, 460 U.S. 226, 243 (1983). Nevertheless, the Commerce Clause, as distinguished from section 5 of the Fourteenth Amendment, does not provide Congress with authority to override the state's sovereign immunity. *See supra* text accompanying note 148.

or state judicial remedy for private litigants against nonconsenting states to vindicate whatever rights it may establish under its commerce powers. Second, it seems equally apparent that Congress would be unsuccessful in attempting to invoke the Fourteenth Amendment for these purposes. We doubt that there is any more evidence in the context of state taxation of electronic commerce than there was in the context of state patent infringement in *Florida Prepaid* or of age discrimination in *Kimel* that the states have caused " 'widespread and persisting deprivation of constitutional rights' of the sort Congress has faced in enacting proper prophylactic § 5 legislation."[162]

Does this mean that we should fold our tents and go home because, whatever substantive rules Congress may enact with respect to state taxation of electronic commerce under the Commerce Clause, it is helpless when it comes to creating a federal or state remedy for private litigants to enforce those rules against nonconsenting states? The answer, in our judgment, is an unequivocal "no." For one thing, as the Court itself observed, the existence of sovereign immunity "does not confer upon the State a concomitant right to disregard the Constitution or valid federal law."[163] The states and their officers are bound by their obligations under the Constitution, and one cannot assume they will lightly disregard those obligations even in the absence of a judicially enforceable remedy.

Furthermore, as the Court also observed, there are several avenues for judicial enforcement of whatever rights Congress may create with respect to state taxation of electronic commerce under its Article I powers. As the Court observed in *Alden*, there is no constitutional bar to an action brought by the United States in federal or state court to vindicate these rights, and Congress could surely authorize such suits in any legislation directed to state taxation of electronic commerce. Moreover, private litigants can sue state officers for injunctive or declaratory relief to enforce federal rights in federal or state court without treading on state sovereign immunity from suit.[164]

More importantly, however, is the simple fact that states have generally consented to be sued in their courts with respect to state tax controversies.[165] Consequently, in most instances at least, taxpayers will

162. College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 119 S. Ct. 2199, 2202 (1999).

163. *Id.* at 2266.

164. *See* General Oil Co. v. Crain, 209 U.S. 211 (1908).

165. Indeed, it is for this reason that the question of state sovereign immunity in tax cases

be able to vindicate whatever federal rights Congress may create pursuant to its commerce power under existing state remedial procedures. This is precisely what happens today when taxpayers sue in state court to vindicate their rights under such federal statutes as Public Law 86-272.[166] In short, there does not appear to be a legitimate concern that private litigants will be without a judicial remedy to enforce whatever substantive rules Congress may create under its commerce power with respect to electronic commerce.

Finally, and most importantly, Congress could address this issue by requiring the states to waive their immunity from suit in return for a relaxation of existing dormant Commerce Clause restraints on jurisdiction to impose sales and use tax collection obligations. The Court has recognized "a variety of methods, short of outright coercion, by which Congress may urge a State to adopt a legislative program consistent with federal interests."[167] For example, "Congress may attach conditions on the receipt of federal funds,"[168] it may "offer States the choice of regulating . . . activity according to federal standards or having state law preempted by federal regulation,"[169] and it may employ "any other permissible method of encouraging a State to conform to federal policy choices."[170]

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has arisen in *federal* rather than state court. *See* South Cent. Bell Tel. Co. v. Alabama, 119 S. Ct. 1180, 1184 (1999) (dismissing contention that Eleventh Amendment bars U.S. Supreme Court review of tax refund suit initiated in state court); McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, 496 U.S. 18, 28 (1990) (same). Moreover, because of the Tax Injunction Act, which provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State," 28 U.S.C. § 1341 (1993), state tax cases may only rarely be maintained in federal court. It is worth noting, however, that in the one context in which Congress has purported to create federal jurisdiction over state tax issues, namely, with respect to discriminatory taxation of rail and motor carriers, see 49 U.S.C. §§ 11501(b), 14502 (1997), there is currently considerable controversy over the question of whether such purported abrogation of state sovereign immunity is an appropriate exercise of Congress's power under section 5 of the Fourteenth Amendment. *See, e.g.*, Union Pac. R.R. v. Utah, 198 F.3d 1201 (10th Cir. 1999); Wheeling & Lake Erie Ry. v. Public Util. Comm'n, 141 F.3d 88 (3d Cir. 1998), *cert. denied*, 120 S. Ct. 324 (1999); Oregon Short Line R.R. v. Department of Revenue, 139 F.3d 1259 (9th Cir. 1998).

166. *See supra* note 125 and accompanying text.

167. New York v. United States, 505 U.S. 144, 166 (1992).

168. South Dakota v. Dole, 483 U.S. 203, 206 (1987) (spending power permits Congress to condition highway funds on states' adoption of minimum drinking age).

169. *New York*, 505 U.S. at 167.

170. *Id.* at 168.

Accordingly, Congress could condition the congressional overruling of *Quill* on the states' consent to suit for enforcement of whatever other rules Congress may provide limiting the states' power to tax electronic commerce. This should allay any concern about creating a right without a remedy. Moreover, such a requirement would satisfy the constitutional requirement of an "effective waiver"—the "intentional relinquishment or abandonment of a known right or privilege."[171]

B. Due Process Clause Considerations

In addition to arguing that Congress lacks the power under the Commerce Clause to fashion a broad solution to the problem of state taxation of electronic commerce, one might also contend that such legislation would purport to authorize violations of the Court's due process doctrine and that, unlike Congress's power to consent to what otherwise would be violations of the Court's dormant Commerce Clause jurisprudence, Congress lacks the authority to consent to due process violations. The question must be answered in two parts. First, would the congressional legislation authorize violations of the Due Process Clause and, if so, does Congress have the power to eliminate the due process bar?

The answer to the first part of the question depends on whether a state would have the "definite link" or "minimum connection" that the Due Process Clause requires "between a state and the person, property or transaction it seeks to tax."[172] The Court in *Quill* construed this requirement to remove any condition that the "link" or "connection" be physical: "The requirements of due process are met irrespective of a corporation's lack of physical presence in [a] State."[173] What is required is that the out-of-state taxpayer "purposefully direct" its activities towards residents of the taxing state.[174]

Whether the congressional legislation would satisfy this criterion would, of course, depend on the precise nexus requirements in the federal legislation and on the particular facts of the case. In other words, even if the legislation authorized states to require collection of use

171. College Sav. Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 119 S. Ct. 2199, 2229 (1999) (citation omitted).

172. Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954).

173. Quill Corp. v. North Dakota, 504 U.S. 298, 308 (1992).

174. *Id.*

taxes that, in some circumstances, would exceed state power under existing due process doctrine, the statute would arguably be invalid *only* in those circumstances. It would not provide a basis for attacking the legislation on its face, since in most of its applications it would likely be unobjectionable.

Even assuming that, in some circumstances, congressional legislation might authorize the exercise of state taxing power that exceeds state authority under the Due Process Clause, it is an open question whether such legislation would nevertheless be sustained. The Court in dicta has declared that "while Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce . . . it does not similarly have the power to authorize violations of the Due Process Clause."[175] Nevertheless, a strong case can be made that Congress has power to consent to violations of the Due Process Clause so long as they are not restraints by which Congress itself is bound.[176] Under this theory, Congress can authorize what would otherwise be federalism-based violations of the Due Process Clause but not Due Process violations of individual rights.

In the end, it seems unlikely that the U.S. Supreme Court would hold that the framers of the Constitution and the Fourteenth Amendment left the nation powerless, short of a constitutional amendment, to legislate an administratively workable solution to the problem of state taxation of electronic commerce, despite the joint exercise by Congress and the states of their respective powers under the Constitution.[177]

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175. *Id.* at 305; *see also id.* at 318; ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 350 n.14 (1982) (O'Connor, J., dissenting).

176. *See* William Cohen, *Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma*, 35 STAN. L. REV. 387 (1983). *See also* William Cohen, *Congressional Power to Interpret Due Process and Equal Protection*, 27 STAN. L. REV. 603 (1975).

177. As Professor Donald Regan, an eminent constitutional scholar, has put it:

> The crucial question then becomes: Can Congress overturn Supreme Court decisions invalidating state laws on grounds of extra-territoriality? It is an understatement to say there is no settled doctrine on this question. Nonetheless, I would confidently expect the Court to hold that Congress can overturn most, if not all, such decisions, precisely because extra-territoriality is more a matter of federalism than of fundamental fairness.

Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 Before the Subcomm. on Monopolies and Commercial Law of the House Judiciary Comm., 100th Cong. 708 (1989) (letter from Donald H. Regan to Chairman Peter W. Rodino, Jr., U.S. House of Representatives regarding the "Constitutionality of H.R. 3521 and Similar Bills Authorizing States to Require Tax Collection by Mail-

Moreover, even if portions of such legislation were held to violate the Due Process Clause as applied, the lion's share of any such legislation would be invulnerable to due process attack on its face or as applied.

C. Concluding Observations Regarding the Scope of Congressional Power to Address State Taxation of Electronic Commerce

Congress possesses ample power to forge a comprehensive solution to the problems raised by state taxation of electronic commerce. There is no doubt that Congress has the power under the Commerce Clause to legislate with respect to virtually any aspect of electronic commerce. It may restrict the states' power to tax such commerce in ways that Congress finds burdensome, prescribe the precise conditions under which states may tax such commerce, and permit the states to tax such commerce in ways that the Commerce Clause currently forbids. Although Congress may not create federal or state jurisdiction over nonconsenting states to enforce whatever rights it may create under legislation addressed to electronic commerce, the states' courthouses are generally open for the vindication of such rights. Congress could insist that the states waive their sovereign immunity to suit in return for a relaxation of the Commerce Clause restraints on their power to tax remote sellers. There is an open question whether Congress may override any due process limitations on state taxing power, but, even if it may not, these restraints are not extensive and, in any event, would likely affect any broad-based legislation only in limited circumstances on an "as applied" basis.

IV. CONCLUSION

The problems raised by state taxation of electronic commerce have spawned an enormous amount of interest in—and controversy over—the possibility of making dramatic changes in the states' existing sales and use tax regimes. We are hopeful that salutary reforms will emerge from this ongoing process, whose formative stages we have examined in this article. Nevertheless, it remains unclear in the final analysis whether the NTA Project Report or the ACEC recommendations will be the catalyst for meaningful change or will be consigned to the dustbin of history, as have most previous efforts to re-

Order Sellers); *see also* Jerome R. Hellerstein, *Significant Sales and Use Tax Developments During the Past Half Century*, 39 VAND. L. REV. 961, 986-92 (1986).

solve the problems of state taxation of interstate commerce through federal legislation rather than litigation.