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Are You Ready for an Internet Tax?

Veronique de Rugy

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State bureaucrats are always looking for new sources of revenue. For years, they have had their eyes on the revenue collected from out-of-state sales, but Congress has failed to allow them to grab it. Tired of waiting for the authorization they need from Congress, 13 states have decided to start collecting these taxes from out-of-state Internet retailers and are daring merchants to challenge them. The goal: create chaos in hope that it will force Congress's hand and allow the tax grab.

The Wall Street Journal reports:

> The gambit is aimed at creating business blowback and a confusing national patchwork of laws that might prompt Congress to act. Short of that, the states want their moves to be questioned legally so they can ask the Supreme Court to overturn a 1992 ruling that forbids taxation of Internet sales by retailers that lack a physical location in a state. …
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> The moves are a reaction to years of inaction in Congress that have disadvantaged local businesses, said Deb Peters, a Republican state senator in South Dakota. Her bill, which would apply sales taxes to out-of-state purchases, moved through the state Senate last week without opposition….
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> The Supreme Court ruled in 1992, in Quill Corp. v. North Dakota, that states can apply sales taxes only to companies with a physical presence in the state. As tax-free Internet sales expanded, states and big-box retailers grew increasingly frustrated with the ruling, which dates to the mail-order-catalog era of commerce.

The Journal notes that red states are often the most eager to grab as much tax revenue as they can. But the decision should be left to Congress.

My second preferred solution (after the current almost-no-Internet-tax situation we have now) would be the implementation of an origin-based tax. I wrote about that reform back in April 2015:

> The main benefit of an origin-based tax is that it encourages competition between the states, giving governments an incentive to limit their sales tax rates in order to attract and keep businesses. Such a system also allows consumers in high-tax states to escape the

> burden by buying from sellers in low-rate states. And because it allows taxes only on businesses within the taxers' jurisdictions, an origin-based tax is in line with constitutional protections for interstate commerce. ..
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> In an ideal scenario, all sales by businesses in California would pay sales taxes at California's 8.41 percent rate, regardless of the location of the buyer. The ravenous desire for more overall revenue, plus the secondary benefits of having companies based in the Golden State (jobs, for instance) would push Sacramento to consider lowering tax rates—driven by the kind of tax competition that benefits customers.

My colleague Adam Thierer and I wrote a policy paper on this issue back in 2003 when we were at the Cato Institute. Ramesh wrote about the benefits of an origin-based tax here. These paragraphs sum up the issue well:

> This would be a much simpler tax system with lower compliance costs. It would tend to constrain sales taxes by increasing competition among the states: A state that raised its rates too high would induce businesses, particularly catalog or Internet businesses that can sell remotely, to locate elsewhere.
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> To my mind, that's a feature, not a bug. State governments that are eager to tax Amazon and other e-businesses because they want cash, rather than because they want fair tax rules, will doubtless see it differently.

The most frustrating aspect of this debate is that states are eager to collect more revenue to fix their budget gap. But they failed as always to understand that their problem isn't a revenue problem but a spending problem.