

## Chapter 13

# Fairness and the Internet Sales Tax: A Contractarian Perspective

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### ABSTRACT

*One of the most noticeable features of online business transactions in the United States is the absence of a sales tax on interstate purchases. Consumers are not expected to pay taxes on Internet purchases across state lines, and businesses are not expected to collect taxes for such purchases. The absence of an interstate Internet sales tax (shortened hereafter to “Internet tax,” except where noted) has been both praised as an incentive to promote business, and condemned as the cause of serious revenue loss by municipalities throughout the nation. In this chapter, I shall present an analysis of current proposals about instituting a sales tax on Internet purchases. Both sides of the debate argue for their position on grounds of fairness to the businesses who, were an internet tax to be levied, would be expected to collect and remit it to the state and local governments. So, I will focus on the concept of fairness in this discussion. I will consider the claims about the fairness or unfairness of the Internet tax from the standpoint of contractarianism: a group of philosophical theories that focus on questions concerning the just distribution of social resources. I will make use specifically of the views of John Rawls and David Gauthier to analyze the positions on the Internet tax. I shall conclude by arguing in favor of the Internet tax on contractarian grounds.*

### BACKGROUND OF THE DEBATE

Since the US Supreme Court’s 1992 Quill v. North Dakota decision, there is a moratorium on collecting taxes on e-business transactions across state

borders. In that case, the North Dakota Tax Commissioner attempted to collect a use tax (a variety of the sales tax, generally filed voluntarily along with state tax returns) for sales in North Dakota from the Quill Corporation, a mail order based office-supply retailer based in a different state. The trial court ruled in favor of Quill, after which

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the decision was appealed to the state's Supreme Court. The North Dakota Supreme Court decided in the state's favor. The case was then appealed to the U.S. Supreme Court. The U.S. Supreme Court reversed the State Supreme Court's decision, deciding that, as long as the company has no brick-and-mortar presence in the state where the item is purchased, Quill owed North Dakota no duty to collect and remit a tax on purchases made by citizens in that state. This decision followed a test proposed in a previous U.S. Supreme Court decision, *Complete Auto Transit v. Brady*. According to that test, a business must have "nexus," that is, a physical presence of some sort, in the state where the sales tax is collected. Lacking such a nexus, there is no constitutional basis for the sales tax. The effect of the Quill decision, then, is that demanding that interstate companies collect and remit taxes places an unconstitutional burden on interstate commerce. The Court noted, however, that Congress could weigh in on the legality of a use tax in interstate commerce. A given state, that is, may legislate certain conditions under which taxes may be collected from interstate companies: Justice John Paul Stephens writes, "No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions" (*Quill v. Heitkamp*, 1992). Lacking such legislation, however, the Constitution's Commerce Clause forbids North Dakota from collecting a use tax from Quill Corporation.

The implication of the Quill decision for e-business is that the majority of Internet sales take place across state lines, like the transactions involved in that case. For this reason, the Court's decision is considered to hold for Internet transactions as well as traditional mail-order purchases. What generates controversy about the Quill decision is the Court's allowance that it is within Congress's authority to determine whether to institute an Internet tax. Congress may, in other words, decide that an Internet tax must be collected.

Opponents of the Internet tax argue that keeping e-business tax-free promotes online retail, and that to levy an Internet sales tax would negatively affect e-businesses and thus the overall economy (Neil, 1996). Opponents argue further that the sheer complexity of instituting an Internet sales tax would be overwhelming, given the nearly 7,500 tax zones across the U.S. The Internet retailer Amazon.com claims, in a 2008 lawsuit against New York State's proposed sales tax bill on e-business, that no clear rule for an Internet tax can be formulated that does not violate the *Quill v. North Dakota* ruling (Hansell, 2008). Supporters of the Internet tax argue that the growth of tax-free online retail as a portion of overall retail sales deprives state and local government of much-needed revenue (McQuivey and DeMaullin, 2000). The percentage of the overall retail sector made up by e-commerce was approximately 6% in 2008 (Vollman, 2008). Most analysts expect the percentage to increase with time. Subtracting the tax revenue from this percentage of the transactions leaves states and local areas with a substantial shortfall, to the detriment of police departments, parks, and other municipal services. Further, although there are considerable complications involved with instituting a sales tax, given the various tax zones, there is nevertheless good reason to suppose that these difficulties can be resolved.

### **Opponents of the Internet Tax**

Both opponents and supporters of the Internet tax tie their positions into questions about the fairness of an Internet tax. Opponents of the sales tax believe that instituting an e-business sales tax would be unfair to the individual businesses. In a discussion characteristic of the anti-tax position, Aaron Lucas of the libertarian think-tank the Cato Institute writes,

*The... most important reason to limit state taxing authority over remote transactions, however, is*

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