

**Statement of John Berthoud, Ph.D.
President of the National Taxpayers Union**

**before the
United States Senate
Committee on Commerce, Science, and Transportation**

**on
Internet Taxation**

April 12, 2000

I. Introduction

Mr. Chairman and Members of the Committee, my name is John Berthoud. I am President of the National Taxpayers Union, a nationwide grassroots lobbying organization of taxpayers with 300,000 members.

I come before you today to state our views on Internet taxation and Chairman McCain's legislation, S. 2255, which would extend the moratorium on Internet taxation through 2006. The National Taxpayers Union strongly supports this effort and encourages the Committee to act favorably on this bill.

II. The Moratorium Should Be Extended

A moratorium is a prohibition on action. We believe government should not act **B** through taxation, spending, or regulation **B** unless there is a clear and compelling reason for it to do so. While proponents of more taxes on the American people have lobbied hard to establish taxes on Internet commerce, a close examination of the facts reveals no justification at all for a) creating taxes on Internet access; b) creating discriminatory taxes on the Internet; or c) forcing vendors to collect taxes for states and cities in which they are not located.

I will briefly examine **B** and refute **B** the claims of the pro-taxing crowd and make the case why it is important to keep the destructive power of government as far as possible from the Internet.

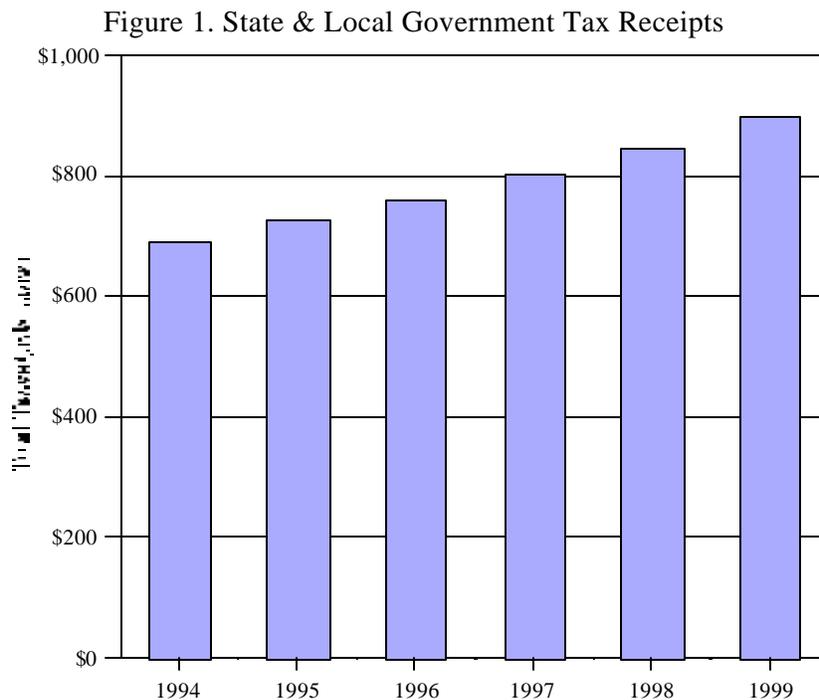
**III. Claim: Failure to Tax the Internet Will Lead to AUnder-Funding of
Critical Government Services®**

Repeatedly, we hear from the pro-tax side that without a new tax regime on the Internet, **A**

critical government services will have to be cut. The pro-tax National Governors' Association (NGA) argues that if the NGA Internet tax plan is not adopted, states and local governments could lose more than \$10 billion per year by 2003 in uncollected sales tax revenues on Internet and mail-order sales. . . . If this problem is not addressed, America would have 200,000 fewer teachers and police officers educating our children and keeping our communities safe.¹

NGA's scare tactics about laying off police and teachers are repeated by other big government advocates who argue in favor of similar tax schemes. However, the facts quickly disprove this type of groundless hysteria.

State governments are flush with money. Total state taxes, including traditional sales taxes, have grown at almost twice the rate of inflation and population for the past six years. Figure 1 shows that state and local government tax receipts grew by over 30 percent between 1994 and 1999.



Source: Office of Management and Budget, *Historical Tables of the Budget of the United States Government - Fiscal Year 2001*, Table 15.1.

Many states such as New York, California, Texas, Maryland, Minnesota, Indiana, Michigan, Washington, and Pennsylvania have seen year-after-year of surpluses exceeding \$1 billion.² One Michigan State Senator commented that as a result of the year-after-year surpluses in that state, we have programs coming out of the weeds groups with something warm and fuzzy, and some of them have merit³ (italics added).

Meanwhile, the federal government's share of the economy has reached a postwar high. In FY 2001, the Office of Management and Budget projects the federal government will collect 54 percent more revenue than it did just ten years ago (adjusting for inflation).⁴

And make no mistake **B** a substantial part of the reason for this boom in revenues is the Internet, e-commerce, and the high-tech sector. Because governments at all levels have so far mostly left the Internet, e-commerce, and indeed, the entire high-tech sector alone, it has been able to flourish. In turn, these businesses have returned massive amounts of revenue to states and localities through the taxes currently in place.

Adding taxes to the Internet would adversely affect e-commerce and in turn stifle the revenue growth that we have seen in most types of state and local taxes. A 1999 study by the National Bureau of Economic Research concluded that applying existing sales taxes to the Internet would slash the number of online buyers by 25 percent and plummet purchases by 30 percent or more.⁵

IV. Claim: E-Commerce Businesses Are Escaping Taxation

Proponents of more taxation argue that it is unfair that Internet businesses are not subject to new types of Internet tax plans - they are supposedly **A**escaping their obligation[@] to fund **A**needed government services.[@] Nothing could be further from the truth.

Businesses in America **B** those on the Internet or those not yet on the Internet **B** are already overtaxed through a great variety of levies. Some of the more prominent ones include:

- C** corporate income taxes
- C** personal income taxes
- C** sales taxes
- C** use taxes
- C** property taxes
- C** literally hundreds of different types of fees

The small business sector would once again be hit hardest by Internet taxation. Their smaller size means that the compliance burdens would be proportionately greater. Chris Wysocki, President of the 50,000-member Small Business Survival Committee, testified to the Advisory Commission on Electronic Commerce that, **A**Allowing the taxation of e-commerce would jeopardize the growth of the new digital economy and hamper the ability of entrepreneurs across America. . . The burdens that would be imposed are simply unacceptable.[@]

Rather than figuring out new taxes to add onto businesses, Congress and the states should be focusing on ways to lower the old ones.

For those businesses who don't currently have an Internet presence and who feel that **A**fairness[@]

dictates the establishment of new taxes on e-commerce, our message is simple: government is never the solution to your competitive problems. More government always ends up hurting commerce. Look instead to getting into the Internet yourself.

The situation with non-Internet retailers pursuing taxes on those with an Internet presence is analogous to the situation where some businesses have lobbied the U.S. Department of Justice to pursue Microsoft in the hopes of achieving a competitive advantage. Any short-run advantage to these firms is clearly outweighed by the longer-run costs of government intrusion. Nobel Laureate Milton Friedman made this point very eloquently in a dialogue with us last year:

Business, in general, has something of a suicidal instinct. It often proposes laws in its own self-interest which destroy the underlying basis of the whole private enterprise system. I believe that is what has been happening recently in the computer industry. Silicon Valley is suicidal in calling government in to mediate in the disputes among some of the big companies in the area and Microsoft. The end result will be that an industry that up to now has been able to proceed at a marvelous pace with little or no government regulation **B** it has been a wonderful example of the efficiencies of a strictly free private-market **B** that industry is now going to have government all over it. It's going to spend in legal fees over the next ten or twenty years, money which society would benefit from much more if it were spent in the kind of research and development that has brought us the many miracles in the area of Internet, in the area of home computers, industry computers, and all the rest.⁷

V. Why Do Proponents of Internet Taxation Want to Add Internet Taxes?

It is quite clear why advocates of Internet taxation have lobbied hard for Congress and state legislatures to either establish special taxes on the Internet or else create new tax regimes to snare e-commerce in the web of state sales tax collectors. They want lots more money from taxpayers to fund their plans for even bigger government.

One of the clearest examples is that of America's teacher unions. One of the strongest voices for more taxes **B** on the Internet and everything else **B** America's teacher union leaders are pushing an agenda that would add \$906 billion to the existing mountain of federal spending.⁸ That's each and every year. To enact an agenda of this size would require a staggering tax increase of \$7,490 per taxpayer.⁹

Advocates of Internet taxation are advancing this idea to help fund their dreams for a massive expansion in government. This agenda is bad news for taxpayers and America's future.

VI. Practical Considerations

Mr. Chairman, your legislation extending the moratorium makes sense for all the reasons noted previously. But even if Internet taxes wouldn't add a huge burden to businesses and even if states

were not already overflowing in revenues, there are more practical reasons to continue the moratorium. For example, we have yet to hear a sensible argument on who would be owed a tax if a resident of Arizona, using an Internet Service Provider located in Utah, ordered a product from a company headquartered in Delaware, but whose main office is in Maine, and who ships their goods from New York. Absent a moratorium, we would expect to see state or local legislation that could lead to taxes being paid to a variety of these jurisdictions, meaning multiple taxation placed on a single sale.

And we would anticipate that it will be very difficult for tax and regulatory laws to keep pace with technological change as it occurs. We do not want to put laws in place that will quickly be made obsolete. As the respected *Economist* magazine argues, "The Internet is so new that the direction of technological change is fiendishly hard to predict. By contrast, tax rules are precise and inflexible, and take a long time to change."¹⁰

VII. Conclusion

As you well know Mr. Chairman, the debate over taxes has been central to the 2000 election cycle. While you and others offered wise and sensible plans for reducing the federal tax burden and returning some of the current federal tax over-payment (what is also called the surplus) to its rightful owners, the American taxpayers,¹¹ the issue we are talking about today is probably of even greater long-term significance to taxpayers.

We thus strongly support this legislation and indeed, we urge Congress to go further and adopt your legislation S. 1611, which would amend the Internet Tax Freedom Act to broaden its scope and make the moratorium permanent. We have also endorsed H.R. 3252, the Internet Tax Elimination Act sponsored by House Budget Committee Chairman John Kasich, which would bar sales taxes and other taxes on e-commerce.

In conclusion, I want to quote one of the great political philosophers of the Twentieth Century, former President Ronald Reagan, who observed, "A Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it." Now is the time, Mr. Chairman, to put a stop to schemes to tax the Internet "B" to keep it moving and growing, so government one day does not have to regulate it or subsidize it. This is the challenge before you and the Members of this Committee.

Thank you.

Endnotes

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1. **A** Sales Taxes and the Internet **B** Myths and Facts,@ National Governors= Association web site, <http://www.nga.org/Internet/Facts.asp>.
 2. Peter T. Kilborn, **AA** Resurgent Michigan Leads Newly Flush States,@ *The New York Times*, April 10, 2000, Page A1.
 3. *Ibid*, Page A16.
 4. Office of Management and Budget, *Historical Tables of the Budget of the United States Government - Fiscal Year 2001*, Table 1.3.
 5. **AA** World Without Borders: The Impact of Taxes on Internet Commerce,@ National Bureau of Economic Research Working Paper No. 6863, 1999.
 6. **A**Fed Panel Urged To Keep Web Tax Free,@ *The Associated Press*, December 15, 1999.
 7. **A**Dr. Milton Friedman Talks with National Taxpayers Union President John Berthoud,@ Spring 1999 - San Francisco, California.
 8. Jared Adams, **A**What About the Children?= The Legislative Agenda of the National Education Association and the Politics of New Unionism,@ NTU Foundation Policy Paper 122, October 19, 1999, Page 1.
 9. *Ibid*.
 10. **A**Why the taxman fears the Internet,@ *The Economist*, January 29, 2000.
 11. Contrary to the opinion of many **A** Inside-the Beltway@ experts, Americans believe they are overtaxed and want to see federal tax dollars returned to them rather than spent on more government programs. This was brought out in polling by John Zogby last September:

Q. Statement A says that tax refunds should be returned to those who were overtaxed.

Statement B says tax refunds should be kept to shore up effectiveness of government programs.

Respondents who agreed with:

Statement A	64%
Statement B	27%
Neither	6%
Not Sure	3%

(Source: **A** Zogby Poll Sets New Course for America,@ *The O=Leary Report*, Vol IV, Issue V, September 1999, Page 3.)