Don't Tax the Internet—Yet

By Jack Stephenson
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The World Trade Organization should be applauded for the agreement its members reached last month to keep the Internet tax-free for at least another year. Unfortunately, the WTO's members didn't go far enough. The agreement covered only products delivered electronically on the Internet, not physical items ordered on the Internet and shipped across borders—although it remains unclear whether something like an airline ticket, printed on paper, constitutes a physical product.

But at least the WTO move seems to have pre-empted the German Finance Ministry's radical plan to establish a global tax system as quickly as possible. What the tax enthusiasts don't understand is that by the time their bureaucrats print the tax code, the mercurial Internet will have made it irrelevant. At this stage of the Internet's development, governments should be focusing on building an infrastructure that will help the Net grow.

It's easy to understand why governments everywhere are worked up about Internet taxes. The figures vary widely, but a recent report by Nua Internet Surveys estimates that 122 million people worldwide are on-line. The annual user growth rate in the U.S. is running above 40%. Estimates of consumer spending on the Internet for 1996 range from $140 million to $1.2 billion; predictions for 2000 range between $7 billion and $32 billion. Business-to-business e-commerce might be over $100 billion by 2000.

But even the highest of these figures represents only the tiniest fraction (well under 1%) of the world economy. Tomorrow this dribble may well become a flood, but not if governments move too quickly in pursuit of what are relatively modest tax revenues. There are two reasons premature action would probably botch things: First, the diffuse nature of the Internet makes taxation an extraordinarily tricky issue. Second, Net commerce is so new, we don't even know what the basic business model will look like in a few years. So how can we know how to tax it?

Regarding the first problem, consider a basic conundrum: A French executive on a business trip in Texas goes on-line via his Belgium-based internet service provider and orders a product from a company based in Germany whose Web page is sitting on a server in California. Who pays tax on what where? A current Texas plan would impose an access fee in Texas; a California plan would insist sales tax be paid in California. And this is before Germany, France and Belgium are considered, where all sorts of crossborder complications lurk.

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To its credit, the German initiative seeks to avoid precisely the unmanaged—and disastrous—emergence of a crazy quilt of incompatible tax structures. However, its plan to "solve" this problem is to levy a tax in the country in which the goods were consumed. Suppose (a big supposition) international agreement could easily be reached on this suggestion. How is it to be enforced? Are we to rely upon the honesty of customers and merchants themselves to report Internet purchases (an approach that has proven less than effective in the U.S. catalog industry)? Or will governments be routinely monitoring and decrypting our personal e-mail messages? An impossible task and a chilling idea.

So far we have only considered taxing hard goods on the Internet. What about a fee charged for playing a video game or downloading an article? What about information transmitted by e-mail or found on a bulletin board? And we don't even know what issue the future will bring. Will e-commerce be supported mainly by advertiser revenues? By commissions on transactions? Might elaborate barter systems emerge in which people trade information as a form of on-line currency?

Had we set about taxing the Net five years ago, we would have focused on the on-line services such as Delphi, Prodigy, CompuServe and America Online that were the locus of consumer on-line activity. Two years later Netscape's browser burst upon the scene, and it was widely assumed that AOL and its brethren would go the way of the dinosaurs. Any nascent tax code would have been scrapped, and a new one developed for the everything-and-anything-goes Web that was suddenly coming into being. Today, however, Delphi, Prodigy and CompuServe have faded from view—but AOL has re-emerged as one of the most powerful of the Web players. So it would be back to the drawing board again.

Just three years ago, who foresaw a world in which entire compact disks could be downloaded off the Web? How long will it be before pay-per-view comes to your browser—and what's the tax plan for that? Do we need an elaborate structure to tax micropayments—the 50 cents for an article here, 75 cents for a videogame there that many believe will be an important part of Internet commerce?

Nobody knows. And in the absence of such knowledge, the best way all the players concerned—governments included—can help the Net grow is to work collaboratively on what the Net really needs: an infrastructure for simple, robust, cross-border Internet commerce. The tax issue is just one of many complicated questions. And until a simple principle can be propounded—say, that Internet businesses would be taxed no more and no less than they are in the physical world—a moratorium on taxes should be declared.

In the meantime, everyone should get to work on establishing the global standards we need to promote the Net:

- *Privacy protection.* Until different countries' laws are aligned over what may be encrypted—something that is very far from being the case today—the guaranteed privacy the Internet needs will be severely hampered.
- *Security and authentication.* In a commercial transaction, both buyer and seller need to be confident that they are dealing with a reliable counterparty. We need a universal standard for digital signatures, and trusted agents to ensure their authenticity.
- *Uniform rules and procedures.* More generally, it's quite unclear how we will apply the physical world's commercial codes—in the U.S., the Uniform Commercial Code—to the whole area of contracts, dispute resolution processes, legal enforceability of receipts, nonrepudiation of transactions, payments and delivery in the electronic universe. Over time, a pattern of practice will develop and some clarity will result—if it is allowed to.

In other words, the regulators should take a back seat for a while, and let Net business find its own way. Until John Citizen believes his communications and transactions are private and secure, and until he feels sure that the cyber-merchant at the other end of an Internet connection can be made liable when a virus in the pop song he just downloaded erases his hard drive, it is too soon to tax the Internet.

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