

## Taxation and Regulation of the Internet

“Show me an untaxed corner of the economy, and I’ll show you politicians eager to plunder a new source of revenue” (Bettelheim). These are the words of Adam Thierer, Director of Progress and Freedom Foundation's Center for Digital Media Freedom. Mr. Thierer needs not to look any further than the Internet to find a venture that serves [ten percent of the world’s population](#) everyday without implementing any state taxes or governmental regulation upon its customers. Since the dawn of the Internet, both producers and users of the tool have maintained its “network neutrality, or the nondiscrimination of access, content, speed, and treatment of the Internet” (Lessig). Meaning, the Internet functions as a free and unregulated system that advocates continuous innovation and maximized market competition (Martinez). Not only does the Internet sponsor over two thousand online merchants, over sixty percent of its websites accessible are constructed by private organizations or individual persons (Martinez).

While the Internet provides utmost service in primary research, entertainment, and e-commerce, there is growing concern about the protection of privacy and the liability of personal information, sensitive material, and intellectual property online. Moreover, the issue of taxing products purchased over the Internet has become less subtle in the last few years due to a study by the National Conference of State Legislatures and the National Governor’s Association. The results showed a \$23.6 billion dollar loss over a seven-year period in potential sales-tax revenues for a mildly populated state (Bettelheim). As of today however, the Internet remains an unregulated and untaxable enterprise, but the question stands in regards to how long will that application suffice for the Internet-using population as a whole. Chapter 8 of David Garson’s book, Public Information Technology and E-Governance, explores the possibilities of Internet regulation and taxation on several subject matters as well as provides open doors to continue the investigation of the legitimacy of regulating the Web and whether it helps or hinders the “network neutrality” function so dearly coveted.

Garson spotlights several topics in his book when addressing regulation, including monopolistic activities, intellectual property, and sensitive material presented on the Web. Almost all of these issues portray the inability for individuals and organizations to self regulate even in the presence of legislation, therefore initiating the idea of governmental regulation over the Internet. For instance, the Sherman Antitrust Act of 1890 states that “it is illegal for corporations to engage in monopolistic conduct, or otherwise act in the restraint of trade”(Garson 228). Yet we find that corporations such as IBM and Microsoft have no trouble suppressing competition with monopolistic activity like software bundling and price fixing. Legislation like the Computer Fraud and Abuse Act of 1986 and the Internet False Identification Act of 2000 has done little to prevent the e-crimes committed against seventy percent of online organizations in 2003 (Garson 235). The Digital Millennium Copyright Act of 1998 (Garson 240) prohibits the copying of digital media, but free, downloadable sharing software like Ares and Limewire still exist. Finally, the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 requires pornography sites to include warnings, opt-out methods, and non-deceptive titles, but almost two thirds of pornographic websites do not consist of these warnings and three quarters displayed sexual content on its opening page (Garson 246).

Taxation imposed on the Internet, either through e-commerce or online gambling is a more political and fiscal matter between the government and the Web. The Internet has pulled in more than [thirty-nine million consumers](#) since 1999 for online shopping. The American Marketing Corporation of America estimated that over \$8.2 billion dollars are spent online, and total U.S. business intrastate purchases range from \$31 billion to \$51 billion a year (Bettelheim). Almost all of these purchases, however, are not subject to a state tax. According to the Commerce Clause in the United States Constitution as well as the Due Process Clause under the Fourth Amendment, taxation of any kind applied to merchants outside the state is violating the free flow and equality of interstate commerce. This principle was upheld by the Supreme Court’s ruling under *Quill Corporation v. North Dakota, 1992* (Garson 226), and has not been overturned since. Because of

this nontaxing ability by the state and government, consumers are more eager to buy products online than in physical stores. Almost sixty-six percent of U.S. residents shop on the Internet, which equates to an estimated twenty percent tax revenue loss of local state taxes through local merchants (Bettelheim).

Online gambling shares a similar effect with state revenues. Data presented by the American Gaming Association suggests that the revenue produced by online gambling for 2005 was around [11.9 billion](#), and over eight million people from the United States use online gambling services. Several legislative initiatives such as the Unlawful Internet Gambling Funding Prohibition Act of 2003 and the Gambling Licensing and Regulation Commission Act of 2004 were issued to the Senate to either tax online gambling or ban it altogether, but none were passed (Garson 248). If the U.S. regulated the industry in 2004, the states would have earned over 1.2 billion in taxes (Payne). Instead, the projected 16.9 billion dollars in online gambling revenue by 2009 (Garson 246) will avoid circulation into state budgets due to the legal incapability to tax in this market.

It seems therefore, that the trend set by both Garson's chapter and by empirical evidence is that regulation and taxation are not welcoming structures when regarding the Internet. Although "surveys show that people generally want new laws to protect their online privacy and safeguard against fraud," businesses and organizations are attempting to provide their own protection for online customers without the aid of government (Bettelheim). Moreover, government regulation is considered to be by many anti-regulation coalitions an innovation killer that "degrades the whole Internet experience, harms consumer choices, and eliminates fair competition" (Martinez). Fear also lingers in that if government is willing and able to regulate the Internet, legislation for taxation of e-commerce and gambling are not far behind. The concern is that regulation and closely followed taxation will decrease the goods and services provided by the Internet and therefore raise the costs of remaining commodities for users around the globe, which will ultimately "distort the development of the electronic market and retard commerce on the Internet" (Haq). But taxing the users of the Internet is not an easy task, and legislative state bodies are not eager to sort out the

complexities. Not only do individual states have to side step the possibility of tax overlap with other states, they must tax un-biasly to avoid violating Due Process. To do this, they must tax goods and services purchased over the Internet and transported by mail as well as the goods and services bought and delivered via Internet (Haq). This serves up a difficult if not nearly impossible chore, one that states figure will take too much time, effort, and direct enforcement. Additionally, local governments would struggle with taxing even more nowadays since the international exchange has grown so rapidly that it accounts for over \$270 billion dollars of U.S. exports alone (Haq). Being able to locate and tax the international individual or party that receives U.S. purchased goods is a start of a headache that states feel not obligated to deal with at this time.

In recent news, the House Judiciary Committee approved legislation in May 2006 called the [Internet Freedom and Nondiscrimination Act of 2006](#), which would “mandate network neutrality to ensure competitive and nondiscriminatory access to the Internet” regarding broadband service providers (“House Judiciary Committee Approves Internet Regulation.”). Yet only a month later, the Senate Committee approved a bill that will allow phone and other telecommunication companies to compete with cable companies that dominate the Internet service in order to provide better service and prices to select customers (Abrams). With this bill, the gatekeeping that the Internet Freedom and Nondiscrimination Act promised has broken open, allowing certain service companies to charge fees to Web providers in order for their content to download quicker than others. The ‘cost to view’ ultimately creates favoritism in Internet viewing due to service, which in turn violates the concept of net neutrality (Martinez). “Major industries such as health care, finance, retailing, gambling, etcetera, will be facing huge tariffs to secure internet service and confront controlled access and distribution of content; providers will decide what you [the consumer] see depending on how much it costs for you to see it” (Martinez). This hypocritical move from the government has infuriated supporters such as the Christian Coalition of America, Moveon.org, the Service Employees International Union, the American Library Association, and a long list of entrepreneurs and e-retailers. States Jeff Mazzella, president of the

Center for Individual Freedom; "It's nothing more than a direct tax on consumers. The government is going to put the breaks on innovation and investment. It's also going to hurt customers through higher prices and they will be forced to bear the burden for new infrastructure investments" (Martinez).

To add to the battering of the concept of network neutrality, Congress just passed a ban on Internet gambling, which will prohibit online gambling services to accept credit cards, checks, or transfer electronic funds to e-gamblers (Batt). Some think, however, that the ban will hurt the actual casinos by taking away the new players that learn gambling online before hitting the real tables. Moreover, it has not been decided how and who will enforce this new legislation on the Internet. "I am not persuaded that Internet gaming could be regulated," affirms former Senator Richard Bryan. "Is there technology today that can regulate Internet gambling? I just don't know" (Batt).

Even if the government decides that the Internet is worth investing an immense amount of time and energy into regulating and taxing, which it already has lately, the key question is how will they administer the legislation efficiently and effectively with the Web as large as it is? Internet content has showed no signs of stagnating, most likely due to the net neutrality that is implemented with its users. In fact, it has increased every year by factors of 10 since 1998, and user statistics has yet to reach a peak (Masci). The Internet itself, due to its sheer size, is not capable of internalizing structured legal restraints, let alone enforce any. If anything, the Internet must depict a freedom zone to which legislative chains cannot be successfully linked around to form a regulatory sector. With all the regulation laws that are being formulated now and mostly likely will continue to be passed in the future, it is highly unlikely that the Web and its customers will surrender to potentially limiting rules and regulations that have no reinforcement backbone. It is net neutrality that the founders of the Internet built this massive communicative and interconnected network on, and net neutrality it will stay.

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