

The Impact of
Electronic Commerce

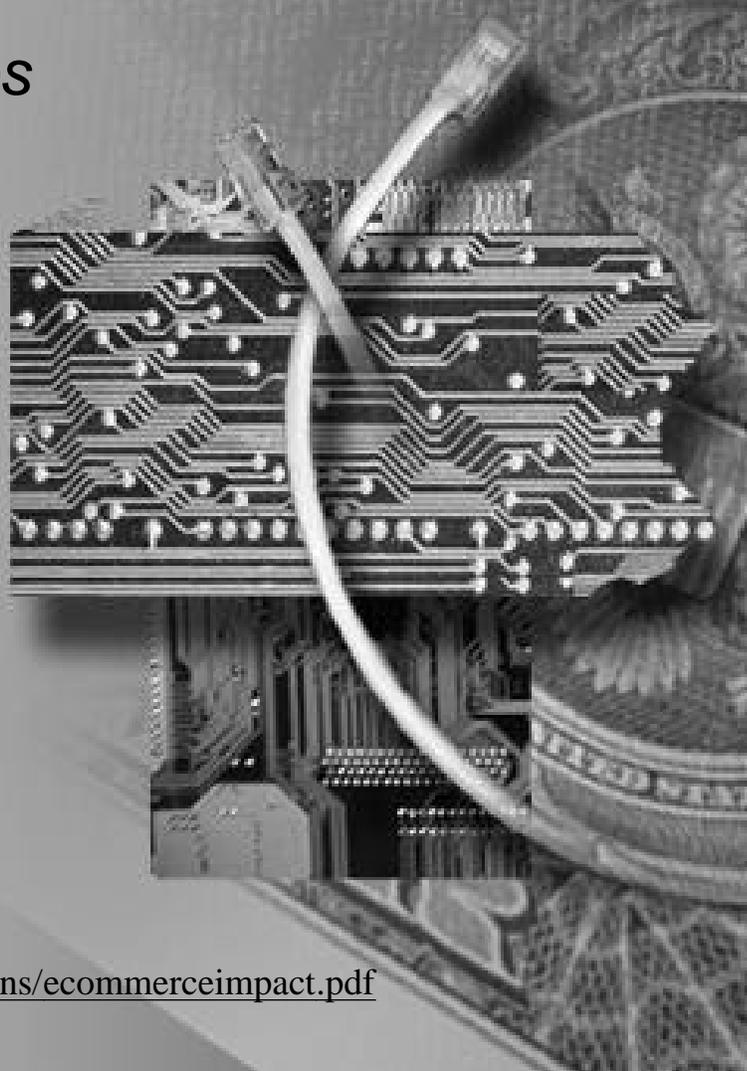
on Pennsylvania Sales
and Use Tax

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and Tax Research Conference**

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The text of report can be found at:
www.revenue.state.pa.us/forms/publications/ecommerceimpact.pdf



Overview

- Growth of the Internet Economy
- Challenges to the PA Sales and Use Tax
- Revenue Losses Associated with Internet Sales
- Conclusions



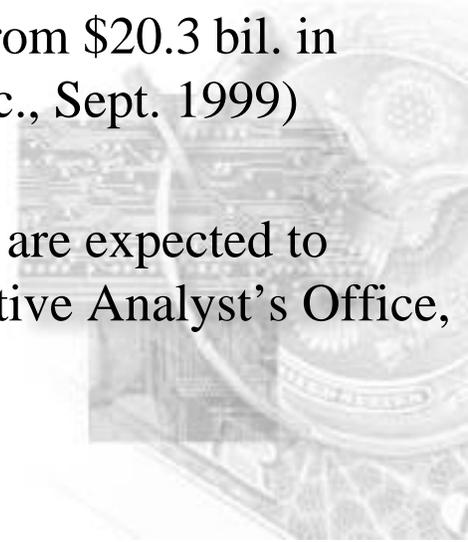
Growth of the Internet Economy

50.1% of U.S. households are expected to have Internet access by the end of 2000 vs. 44.4% in 1999. (www.thestandard.com, May 2000)

17 million households were shopping online in 1999. By 2004, 49 million households are expected to make purchases online. (Forrester Research, Inc., Sept. 1999)

U.S. consumer Internet sales are expected to grow from \$20.3 bil. in 1999 to \$184.5 bil. in 2004. (Forrester Research, Inc., Sept. 1999)

U.S. B2B Internet sales of \$100 to \$150 bil. in 1999 are expected to grow to \$1.3 to \$2 tril. by 2003. (California Legislative Analyst's Office, January 2000)



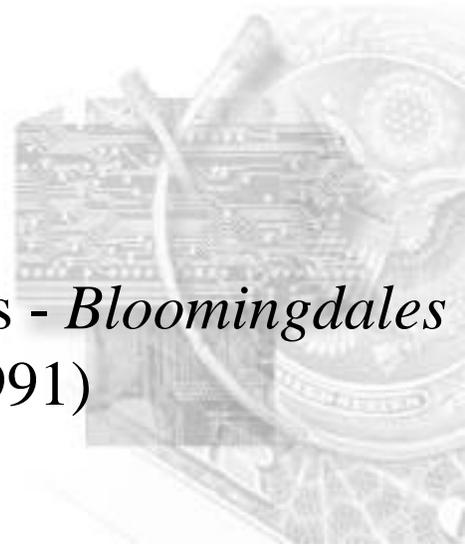
Challenges to PA Sales and Use Tax

- Nexus
- Situs
- Digitized Goods & Services
- Other Market Innovations



The Nexus Challenge

- Economic presence satisfies the Due Process Clause - *Quill v. North Dakota* (1992)
- Physical presence required by the Commerce Clause - *Quill v. North Dakota* (1992)
- Attributional presence may create nexus - *Scripto, Inc. v. Carson* (1960)
- Entity isolation may be used to avoid nexus - *Bloomington by Mail, Ltd. v. Department of Revenue* (1991)



The Situs Challenge

- Who has jurisdiction to tax Internet transactions?
 - Location of vendor may be beyond the reach of state tax laws.
 - Location of purchaser may be unknown.
- Corporate tax apportionment implications.



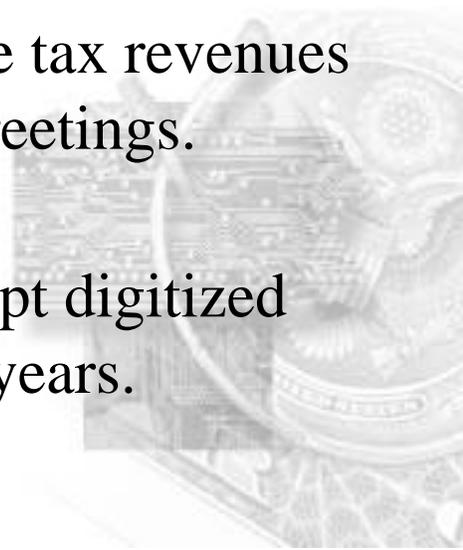
Digitized Goods and Services

Pennsylvania Tax Reform Code (TRC) subjects TPP, services to TPP, and other specified services to sales and use tax.

TRC does not address the electronic delivery of goods and services.

Digitized goods and services likely to decrease tax revenues include software, books, music, videos, and greetings.

ACEC Business Caucus proposal would exempt digitized products and non-digitized counterparts for 5 years.



Other Market Innovations

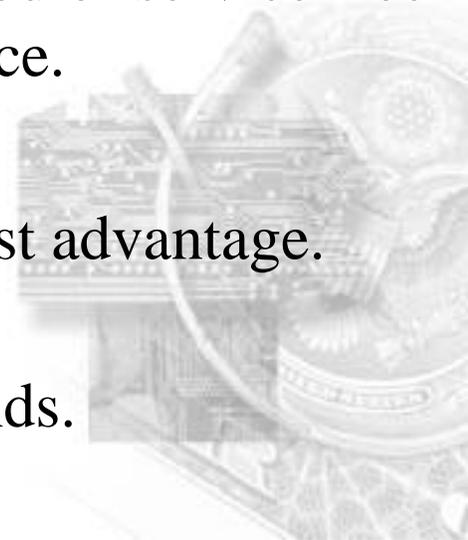
Newly developed non-taxable goods and services may replace taxable products.

The distinction between manufacturers and non-manufacturers may become blurred.

Marketing initiatives to provide a taxable good or service free with purchase of a non-taxable good or service.

Reduced purchase prices through Internet cost advantage.

The Napster model demonstrates market trends.



E-Commerce Impact on Distribution Costs

	<u>Traditional</u>	<u>Inter</u>
Airline Tickets	\$8.00	
Banking	\$1.08	
Bill Payment	\$2.22	
Term-Life Insurance	\$400.00	\$
Software Distribution	\$15.00	

Source: OECD, The Economic and Social Impact of Electronic Commerce, 1998



Sales and Use Tax Losses

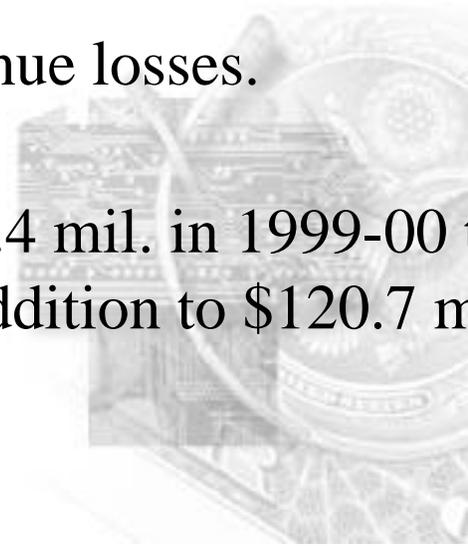
Consumer Internet Sales

A sales and use tax due on consumer Internet sales is expected to grow from \$39.1 mil. in 1999-00 to \$203.2 mil. in 2003-04.

ACIR study (1994) implies that 27.8% of tax may be collected on sales and use tax liabilities arising from remote sales.

Internet auction sales result in additional revenue losses.

SUT losses are expected to increase from \$32.4 mil. in 1999-00 to \$157.3 mil. in 2003-04. These losses are in addition to \$120.7 mil. most due to mail-order sales.





PA Sales Tax from Internet Sales Consumer Purchases

in dollars	1999-00	2000-01	2001-02	200
Consumer Products				
Media	12.2	17.3	23.5	
Event Tickets	Exempt	Exempt	Exempt	E
Apparel	1.6	2.5	3.8	
Books and Flowers	2.2	3.7	6.2	
Entertainment	3.7	8.5	15.0	
Insurance Travel	Exempt	Exempt	Exempt	E
Electronics	12.0	20.8	33.6	
Housewares	3.1	5.9	10.0	
Food and beverage	Minimal	Minimal	Minimal	M
Health and beauty	0.8	1.6	2.9	
Miscellaneous	3.5	6.9	11.5	
Total	39.1	67.2	106.5	

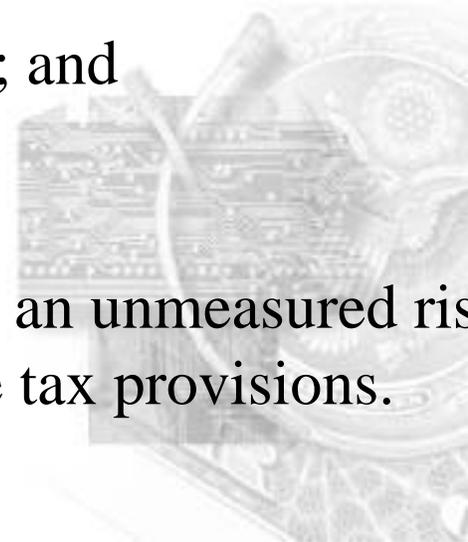
Source: Department of Revenue calculations based on Forrester Research, Inc. data

Sales and Use Tax Losses Digitized Products & B2B Sales

Revenue losses from digitized products are expected to grow from \$1.2 mil. in 1999-00 to \$3.7 mil. in 2003-04, including:

- 100% of Internet greetings;
- 15% of Internet software purchases;
- 2% of Internet music and video purchases; and
- 1% of Internet book purchases.

Revenue losses from B2B Internet sales are an unmeasured risk depending on business compliance with use tax provisions.



Conclusions

Sales and use tax is an important revenue source for Pennsylvania, constituting 15.4% of tax revenues in 1999-00.

The rapid growth of the Internet economy poses challenges that may significantly erode the sales and use tax base.

Revenue losses associated with consumer Internet sales are expected to reach \$157.3 mil. in 2003-04, including losses from digitized products and Internet auctions.

Additional revenue losses may occur from B2B sales due to non-compliance.

E-Commerce creates an unfair advantage for certain industries, types of vendors and consumers.

