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DISCUSSION FOLLOWING THE REMARKS OF MR. HELLERSTEIN AND MR. BROWN

QUESTION, MR. SWEENEY: I would like to pose a question that governments might have concerning e-commerce.

In Ontario, we have a retail sales tax. Under that retail sales tax, the sale of computer software is subject to tax if it is system software, not custom software. The problem is that Ontario's tax basis is different than the other provinces. As a result, one of our clients is finding itself theoretically in a situation of having to pay the tax twice. Clients may begin to ask why they are in Ontario at all? They may consider putting the computer and the rest of the equipment in Bermuda.

Mr. Hellerstein, I presume you have been thinking about this and the problems governments are going to have, state governments, provincial governments and federal governments, in collecting some of these taxes that they like to impose. Would you like to comment on that?

ANSWER, MR. HELLERSTEIN: How many days do you have? You have raised a very good question. This is the question the world is thinking about. OECD has just put out a report on the consumption tax, a subgroup of the Working Party Number Nine on Consumption Tax, which is a body that has been focusing on this. Let me try to summarize where they are and at least where the developed world is with regard to the question.

When you talk about the e-commerce problem, you can think about it as a box with four squares. There is business-to-business and business to consumer. Business to consumer tangible, business to business tangible, business to business digital, and business to consumer digital.

The truth of the matter, to make a long story short, is that there is really only a problem if we do things right with regard to business to consumer digital. Stuff, we know where it is going, and we have borders and we can figure out how to collect that tax under a good consumption tax. Same thing with a digital products, under a self assessment regime, businesses are registered, any sale to a business, ultimately, if we follow the rule about consumption taxes which is consumption should be taxed where consumption takes place, you can enforce that tax. The real problem is a relatively small problem, at least in revenue terms, because eighty percent of e-commerce is business-to-business. The problem only concerns about twenty percent of the entire e-commerce picture. E-commerce is still not all commerce. This little tail should not wag the dog.

There is a problem. For example, how do you collect a business to consumer tax when a business is sending digital products into the European Union? That is the basic problem. I do not think we figured out a good answer. What Europe has said is, "Come register." The U.S. says, "Like hell."

I think the truth of the matter is that if you are large then you are going to comply. Large businesses do not want their products held up at customs. The problem is more for the smaller businesses where compliance is a problem.

I think the solution we are going to see is registration.

ANSWER, MR. BROWN: I think what you will find is that the only solution to the digital and, indeed, to some other aspects of e-commerce, is a multi-national effort to put a box around the thing, and, ultimately, to, in effect, register the people that are doing business through the Internet. Not only is this a problem that is beyond the capability of an individual state and province to deal with, it, frankly, is beyond the capability of the national government to deal with. An international solution is the only way to go. That implies a substantial degree of uniformity. It means that you do not sit down at the state or provincial level and do your own thing. You have to get on the train.

The problem will not be solved by aberrations, such as in Europe deeming servers to be permanent establishments and so on. In e-commerce, you can put your server in Patagonia. Location is not an indication of tax nexus for electronic commerce.

QUESTION, MS. REDDY: I read an article about the U.S. limited liability corporation (LLC) form not being recognized in Canada and being subject to Canadian taxes, double taxes, could you comment on that? Like S Corporations and C Corporations, LLCs are not recognized by Canada and doing business there is creating a double tax situation.

ANSWER, MR. BROWN: LLCs give rise to some interesting tax issues. In Canada, they may very well be treated as corporations, whereas in the U.S., they are treated as partnerships. This can give rise to double taxation. However, It is much more probable to give rise to tax avoidance. In fact, the whole field is proliferated with people that use these to avoid Canadian and U.S. taxes. For every dollar in double tax in this field, I would suggest there is one hundred dollars of tax avoidance through appropriate use of corporations. It is an issue, and in a perfect world you have a more uniform definition of what is a corporation for tax purposes.

COMMENT, MR. ROBINSON: I can comment on that as a practice note. What you should use is called the unlimited liability corporation.

QUESTION, MR. TENNANT: It seems to me that the Michigan single business tax and the e-commerce problem are similar because they both concern the power of the states to collect tax. There are a large number of

people who are very frustrated with the inconsistencies, with the problems that arise in these situations. Could you comment on that? I am thinking particularly here of Mr. Hellerstein on just what it is going to take, how long it is going to take, what the forces would be, particularly in the U.S., in terms of moving to get some discipline in the non-corporate income tax area. Is taxing e-commerce part of what is going to help drive this change?

ANSWER, MR. HELLERSTEIN: That is a good question. What you have identified is, in fact, precisely what is happening right now, at least is beginning to happen in response to the e-commerce issue. Again, you have to understand this is very small tail wagging a very big dog. We are concerned about e-commerce because even though it is a small part of the economy, it is almost a nonexistent part of our consumption tax base.

A goods consumption tax taxes goods and services. States do not generally impose a tax on services. That means that states do not generally impose a tax on digital goods, with some exceptions. Texas, they will impose a tax on information, data processing. But most states do not tax most services.

Ironically, you have this e-commerce issue. Where is the tax base going that is awakening us to what our real problem is, is that we have a huge distant selling problem. If I go to Oregon and buy a car, there is no tax. Oregon is one of the five states without a sales tax. I bring my car back to Athens, Georgia. I go to register it. I have to pay a use tax equal to the sales tax as if I had purchased it in Georgia. Now, I go to Amazon.com. I buy my book. I get it delivered. What happens? I go to the book registry to register my book and pay my tax? No. As long as we have the First Amendment we will not have a book registry. That is our problem. We have a big distance-selling problem. The U.S. Supreme Court in *Quill* said, and this goes back to your point, our system is so unharmonious, not just that they are different rates, different basis. One example given is that even though most states tax clothing, eight states do not. If you buy gloves with fifty-five percent fur for one hundred ten dollars in those eight states that quote exempt clothing, some states you will tax because the fur content is too high. It is unbelievable.

COMMENT, MR. SCHAEFER: I hate to end on such a note of pessimism, but states are most sensitive about their taxation authority. So when you are looking at international constraints to state activities, state taxes are going to be the toughest nuts to crack.

The state tax regulators went so far in the General Agreement on Tariffs and Trade (GATT). The reservations for state tax measures are so broad; it is basically an entire exemption. One might look at the list of reservations for state tax measures and the general agreement on trade and services as part of the World Trade Organization (WTO) and say that they are unbelievably

broad. What they originally wanted was a provision that said any tax legal under the Dormant Commerce Clause as determined by U.S. courts is consistent with the agreement.

States do not want to hear anything about international constraints. Even if you think, well, these constraints largely overlap what the U.S. is doing by entering into these agreements, getting trade liberations from foreigners, what we are already required to do under the Constitution with minimal risk that there is some additional constraints. They do not want to hear anything about additional constraints. States do not want to do anything different than the jurisprudence we have dealt with for one hundred fifty years.

COMMENT, MR. HELLERSTEIN: The more things change, the more things remain the same.

MR. SWEENEY: On that note I would like to thank our two speakers for being with us this afternoon. Thank you very much.