2012

The Intergovernmental Politics of Internet Sales Taxation in the United States

Mitchel N. Herian
University of Nebraska - Lincoln, mherian2@unl.edu

Policy & Internet
www.policyandinternet.org

Volume 4, Issue 1 • 2012 • Article 5

The Intergovernmental Politics of Internet Sales Taxation in the United States

Mitchel Norman Herian, ***University of Nebraska Public Policy Center***

Herian, Mitchel Norman (2012) "The Intergovernmental Politics of Internet Sales Taxation in the United States," *Policy & Internet*: Vol. 4: Iss. 1, Article 5.

The Intergovernmental Politics of Internet Sales Taxation in the United States

Mitchel Norman Herian, ***University of Nebraska Public Policy Center***

Abstract

This article examines the moratorium on Internet sales taxation in the U.S. through perspectives of federalism and intergovernmental relations. First, it provides a brief overview of the literature describing contemporary theories of federalism and intergovernmental relations in the U.S. Second, it describes the efforts of U.S. governors to shape federal policy on the issue with a specific focus on the lobbying efforts of the National Governors Association to repeal the Internet sales tax moratorium. Finally, the paper describes the states' attempts to devise an interstate compact designed to streamline state tax policy across the states with the goal of developing a mechanism to allow states to collect Internet sales taxes outside the purview of Congressional control. Arguing that the relatively recent development of e-commerce and the associated politics have allowed a unique relationship between the state and federal governments to emerge, the paper concludes with a discussion of the possible implications for state/federal relations in the area of e-commerce in the future.

KEYWORDS: federalism, intergovernmental relations, Internet taxation

Introduction

The debate over Internet sales taxation in the United States has come at a time when local, state, and national governments in the United States face a rapidly changing environment. As noted by Scheppach and Shafroth (2008, 42) one of the fundamental questions for U.S. governments in the current economic and technological climate is "whether they will adapt quickly enough or will become a major impediment to economic growth and social justice." Indeed, Internet sales taxation is one issue on which the regulatory stances of governments have the potential to greatly impact profit margins on the one hand, and consumer behaviors on the other. Furthermore, the decision to allow or not allow taxation of Internet sales has come at a time of decreasing revenues and fiscal austerity for all governmental bodies, and as such, the policy has potentially critical implications for the ability of the states to function and meet the demands of citizens.

To date, the U.S. federal government has taken the stance that states do not have the authority to broadly force corporations to collect sales taxes on many of the sales made over the Internet. To be sure, in accordance with the U.S. Supreme Court ruling in *Quill v. North Dakota* a number of states do require the collection of sales taxes on certain tangible goods and require citizens to pay use taxes on many purchases made over the Internet; however, Congress and the federal courts have disallowed the authority of the states to force all sellers to collect many sales taxes on goods, arguing that such taxes would hinder the growth of the industry by placing overly burdensome regulations on it. Working from the position that taxation of Internet access and services—particularly the prospect of having 50 unique state-level policies related to such activity—would stymie the growth of the then nascent industry related to e-commerce, the federal government put in place a moratorium on a number of taxes related to e-commerce with the Internet Tax Freedom Act (ITFA). The initial moratorium was designed to last only three years, but Congress has since passed three extensions of the legislation. The most recent moratorium was adopted in late 2007 and is effective through 2014. With each new extension of the law, states have asked Congress to provide the authority to tax sales of various items and services over the Internet, or at least allow an interstate compact to be developed whereby states could come together to deal with the issue of nexus and devise a scheme to collect sales taxes on their own. An interstate agreement has, in fact, been established on the issue but only a limited number of states have chosen to join the agreement, thereby limiting its effect.

Thus, as evidenced by federal–state interactions on the issue and state efforts to devise an extra-congressional solution to the issue, it has become clear that the Internet tax moratorium—particularly the legal hindrances that have limited states' ability to collect taxes on many goods sold over the Internet—has had a dramatic impact on the federal–state relationship as it relates to e-commerce. Consequently, it is possible to view the relationship between the federal and state governments on the issue through current theories of federalism and intergovernmental relations. The purpose of this article is to do just that: to examine how intergovernmental relations—defined here as both federal–state relations and interstate relations—have impacted the current status of the policy domain. Additionally, this article attempts to describe how state activities in response to federal policy might represent and characterize state–federal relations into the future on this and similar policy issues. Rather than attempt to develop a new theoretical framework through which to understand the relationship between state and federal governments in this policy domain, this article instead offers suggestions regarding the lessons we might learn from recent developments related to state activities in the area of Internet sales taxation.

To carry out this task, a qualitative approach is taken to the study of interstate activities as they relate to intergovernmental lobbying and the Streamlined Sales Tax Project. First, this article provides a descriptive account of the efforts of the states to resist federal legislation limiting states' ability to collect Internet taxes. In particular, it focuses on the efforts of the National Governors' Association (NGA) to lobby the federal government in its attempts to forestall the tax moratoriums that have been put in place over the past decade. Second, the article briefly analyzes the development of an interstate agreement, the Streamlined Sales Tax Project, which has been devised by the states. This interstate agreement is designed to allow states to adopt common tax collection regulations without a need for the Congressional approval that would be required under a more formalized interstate compact mechanism, thereby allowing states to address one of the primary concerns of proponents of the Internet Sales Tax moratorium—that 50 disparate state laws constitute an undue burden on industry—and providing them with the opportunity to generate much-needed revenue from e-commerce. A descriptive, qualitative account of this emergent policy domain has been used here because the approach allows for a more nuanced view of the actions of the states in relation to federal policy.

In the end, because this is a relatively new policy area, and because the issue is as yet unsettled with regard to whether states will succeed in their efforts to develop an interstate agreement on the issue, I draw on current theories of federalism to consider how this policy domain might be characterized by contemporary theories of federalism. In addition, I will consider the potential future impacts of interstate activity on this issue.

Federalism and Intergovernmental Relations

Federalism refers to the institutional structure that exists in the United States whereby the state and federal governments share governing authority. Federalism scholars have distinguished federalism from other organizational structures (e.g., confederacies and unitary governments) by stressing the fact that both national and regional governments in a federal system have control over discrete spheres of activity (Wheare 1964), and that each has control over substantial, rather than trivial, policy domains (Macmahon 1955). The particular form of federalism that exists in the United States is a direct result of historical forces and political expediency—namely, that upon the failure of the Articles of Confederation, the United States sought a political system that satisfied the practical needs and ideological demands of the time.

With regard to the United States version of federalism, scholars have noted the evolutionary nature of the federal–state arrangement (Conlan 2008), i.e., scholars have outlined the constantly changing nature of the relationship between the federal and state governments. For example, scholars have generally agreed that the relationship between the states and the federal government was initially one in which both levels of government occupied separate spheres of activity. This arrangement has commonly been referred to as a “dual federalism” (Nathan 2008). During this time, which lasted from the founding to the early 1800s, both state and federal governments had responsibility for equally important policy activities. However, as conditions shifted and as the need for a stronger centralized government became more apparent through the 1800s and into the 1900s, researchers have described a trend toward “nation-centered” federalism (e.g., Sanford 1967), a move that solidified in the 1930s as the federal government responded to the Great Depression with a number of policies that consolidated power in Washington, DC. These policies were further bolstered by a series of Supreme Court rulings that provided relatively broad interpretations of the constitutionally prescribed roles of the federal government (Kearney and Sheehan 1992). In general, scholars agree that the nation-centered conception of American federalism reached its apex in the 1960s with the Great Society programs. This period has been characterized as a period of cooperative federalism, where the federal government used monetary incentives to guide state and local policy in a wide range of policy areas (Wright 1988). Many observers have argued that the centrality of the fiscal relationship between the federal and state governments under this arrangement put the states at the mercy of the federal government, as financial incentives were used to put the states at a relative disadvantage.

Since the 1980s, scholars have noted a move toward “new federalism.” This term refers to the move to return powers to the states after the flurry of activity in the mid-twentieth century that shifted power to the federal government.

The 1996 adoption of the Personal Responsibility and Work Opportunity Act has often been held up as an example of the new federalism, as broad discretion over the implementation of welfare policies was devolved to the states (though see Conlan 1998). Indeed, many observers heralded the new era of states' rights that appeared to emerge, and a series of court rulings symbolized by *Lopez v. United States* seemed to further bolster the impression that the states' rights were beginning to be reasserted.

Almost immediately after the implementation of these policies, however, scholars disputed the claims that state powers were ascendant. For instance, researchers such as Kincaid (1990; 2001) have argued that states' rights were largely an illusion, drawing upon a wide range of examples to support the claim that the new federalism was largely a myth. More recently, observers have drawn upon a similar line of argument to further suggest that coercive federalism, rather than new federalism, was the most accurate descriptor of federal–state relations in the United States. Such observers use the development of the Department of Homeland Security (Posner 2008), the adoption of No Child Left Behind (Posner 2007), and the adoption of the Real ID Act (Regan and Deering 2009) to illustrate the seemingly coercive nature of the relationship.

Taken together, these theories of federalism approach the relationship between the states and federal government in very broad brush strokes, either claiming one way or the other that the states or federal government are dominant in what is made out to be a zero sum game. In reality, however, the relationship between the states and the federal government is much more nuanced. Indeed, scholars have attempted to account for such nuance by developing conceptual models of federalism that rely on such metaphoric illustrations as marble cake federalism (Grodzins 1960), picket fence federalism (Wright 1988), or more recently, geologic explanations of federalism (Nathan 2008).

In terms of intergovernmental management or intergovernmental relations, these theories allow us to view the relationships through a particular lens, and these heuristics are useful in allowing scholars to draw conclusions about the true nature of federalism in the United States. Furthermore, these theories provide us with a way to understand the relationships between the states and the federal government in such areas of policy as revenue generation. However, what is largely overlooked in the literature is the fact that state–federal relationships are not completely defined by whether one side or the other is in a particular position of advantage or disadvantage. What is ignored is the fact that the states and the federal government are quite dependent upon one another in the delivery of governmental programs. For example, as previously mentioned, responsibility over welfare programs was devolved to the states in 1996. However, this did not simply mean that the states were given full control over the program. Instead, states were given broad discretion over various facets of the policy implementation, but were dependent upon the federal government for the program's funding, and were required to meet a large number of requirements related to its administration. Similarly, as characterized by regulatory federalism, the states and the federal government are responsible for the regulation of various industries and services. As such, there is a sort of symbiotic relationship where states enjoy discretion over the policy, rely upon federal money for its implementation, and must follow federal guidelines in its administration. Through this simple example, it is easy to see how the intergovernmental management of welfare and other policies involve numerous entities at both the federal and state levels through which to carry out programs.

With regard to the implementation of revenue collection mechanisms, the relationships between the states and the federal government are as equally interconnected through constitutional provisions. That is, the power to tax commerce is derived from the constitutional protections of state powers contained in the 10th Amendment to the U.S. Constitution, which says that the powers not specifically granted to the U.S. federal government are reserved to the individual states. The power to tax *intra*state commerce falls into this broad category. The regulation of *inter*state commerce, however, is reserved to Congress through Article 1 of the U.S. Constitution. Thus, Congress has the authority to allow states to tax commerce such as Internet sales transactions that might take place across state lines. However, to date, Congress has not granted states the authority to levy that tax even though such Supreme Court rulings as *Quill v. North Dakota* have given some flexibility in the states' abilities to collect such taxes. Further, Congress has not provided authority to the states to implement an interstate compact known as the Streamlined Sales Tax Project, which is aimed at achieving uniformity in the tax codes of the 50 states. The states, led by the NGA, have resisted the Internet sales tax moratorium put in place by Congress and have repeatedly called on Congress to recognize the interstate compact. To date, however, Congress has not heeded their call. The following account of the NGA's efforts illustrates the extent to which various issues related to federalism and intergovernmental management both affect and are affected by Congressional action on the issue.

State Efforts to Affect Federal Policy: The National Governors' Association

According to a number of observers, the NGA is an organized, well-respected interest group in Washington, DC. Donald Kettl (2003) described the NGA as "long respected as a bipartisan Washington arm for research and lobbying" and David Broder (2003) referred to it as "one of the most influential public lobbies in

Washington" and has commented on the influence of the governors elsewhere (Broder 2001). Cammisa (1995) has provided one of the most comprehensive accounts of the NGA's lobbying efforts from an academic perspective, concluding that the NGA has experienced success in the past because of its access to federal policymakers, its use of "insider" tactics such as providing testimony and making direct contact with decision makers, and because of the prestige of the association. Herian (2011) recently drew on the work of Cammisa to outline the efforts of the NGA on a number of policy matters, finding that the NGA does have fair success in impacting federal policy. In relation to congressional activity on the Internet sales tax issue, the NGA has proven to be the most active of the intergovernmental lobbying organizations. Thus, the NGA provides an appropriate place to begin to highlight the efforts of the states to affect federal policy on the matter.

As an organization, the NGA has been quite active from the outset of federal governmental activity related to the ITFA and subsequent extensions of the moratorium. At their annual meeting in 1997, the governors considered the issue of federal tax policy by stating their general position on the relationship between federal tax policy and the states' ability to collect taxes:

> The nation's Governors have a strong interest in the structure of the federal tax system. First, federal tax policy is critical to the growth in economic output, productivity, and income, which have a direct effect on job creation and the growth in state tax revenues over the long-run. Second, state tax policy is closely linked to federal policy. (…) Since adoption of the U.S. Constitution, Congress has generally respected state sovereignty with regard to state taxes. It is essential that the federal government not preempt, either directly or indirectly, sources of state revenues, state tax bases, or state taxation methods. Unfortunately, over the last few years, Congress has increasingly restricted the rights of states to determine their own tax structure and has not considered the significant impact that its decisions can have on state authority. Recent legislative examples include the moratorium on the taxation of charges for Internet access, prohibiting the taxation of nonresident pension income, and the accelerated elimination of the state death tax credit. (NGA Policy Position EC-09)

Despite the opposition from the governors, however, Congress passed the ITFA in October 1998, thereby placing broad limits on the states' ability to collect various taxes on Internet sales and Internet activities. As early as July 1999, legislation extending or making permanent the original moratorium was already being considered, and again, the NGA took its case to the federal government in an effort to defeat or reduce the scope of any potential extension. For example, on July 28, 1999, the NGA issued a letter to all 100 U.S. Senators indicating their displeasure with the fact that a new moratorium was already being discussed (NGA Letter to Senate, July 29, 1999a). As Congress began to consider such legislation as S. 1611, sponsored by Senator John McCain, which would have broadened the scope of the ITFA and made permanent the moratorium on Internet taxation, the governors again urged Congress to reject the legislation, saying:

> The proposed expansion of the moratorium contained in S. 1611 represents a major assault on state sovereignty. The levy of sales and use taxes is an inviolable right of the states. S. 1611 would prevent states from collecting taxes on mail-order and Internet sales that occur entirely within their own boundaries and have no interstate component whatsoever. Furthermore, S. 1611 would not just be limited to remote sales, but would also prevent states from collecting taxes on many sales that occur in traditional retail stores. This would clearly violate the Unfunded Mandates Act, seriously jeopardize public education funding, and substantially increase discrimination against Main Street businesses. (NGA Letter to Senate, October 7, 1999b)

In early February 2000, former Michigan Governor John Engler, representing the NGA, testified before the Senate Budget Committee restating the governors' position that the states have the ability to work outside the purview of the federal government to devise their own infrastructure for collecting taxes on Internet commerce, and that the federal prohibition of state collection of such taxes was an intrusion into state sovereignty. Further, Engler warned that the moratorium might serve as precedent with which the federal government could effectively prohibit the states' ability to tax any sort of industry that was associated with, or profited from, Internet commerce (NGA Senate Testimony, February 2, 2000a). Notably, at the same Budget Committee hearing where Engler put forth the policy position of the NGA, another governor, Paul Cellucci of Massachusetts, spoke out against the plan put forth by Engler and the NGA. In his testimony, Cellucci insisted that the sales and use taxes are outdated remnants of a tax system that was originally designed to assist state governments in their handling of the Great Depression, and discussed the danger of new levels of private bureaucracy that would be necessary if the NGA's plan to develop an interstate compact to collect sales taxes were to become policy. According to Vadum (2000), the disagreement between Engler and Celucci represented a broader rift in the organization over the Internet taxation issue (it is not clear whether disagreements among governors were the result of party politics; see Broder 2003; Novak 2003; Vadum 2000).

The Advisory Commission on Electronic Commerce (ACEC), which was created by the ITFA, submitted its policy recommendations related to e-commerce on April 12, 2000. The commission recommended a five-year extension of the Internet sales tax moratorium, and recommended clarifying language to better define whether a business has a physical presence in a particular state. The primary goal of these two recommendations was to provide time for the states to perhaps devise a sales tax collection system of their own, akin to the system favored by the NGA. The commission also recommended permanently eliminating all taxes on Internet access, including pre-1998 state taxes that had been untouched by the ITFA in 1998. In response to the ACEC's recommendations and related legislation, the NGA delivered a number of letters to Congress stating that the adoption of new legislation needed to be put on hold until the next year so that all parties could take time to carefully study the issue (NGA Letter to Senate, June 13, 2000b), and also called on members of the Senate to support an amendment put forth by Senators Voinovich and Dorgan (S. 2775) that would have extended the moratorium, but would have also authorized the states to enter into the interstate compact for collecting sales taxes that the NGA had favored from the beginning of the debate over the ITFA (NGA Letter to Senate, July 27, 2000c). Ultimately, H.R. 1552 was passed by both the House and the Senate and became law on November 28, 2001. The legislation extended the moratorium until November 1, 2003.

While the legislation contained portions of H.R. 2526 desirable to the NGA—specifically, the legislation defined what is a "substantial physical presence"—it included no mention of assisting the states in their attempts to devise a uniform tax structure, an issue that had become central to the actions of the states. With three earlier pieces of legislation in the 107th Congress—S. 512, H.R. 1410, and H.R. 1552—the states would have received assistance from the federal government in developing an interstate compact consisting of a uniform method of tax collection among the states. Throughout the consideration of the ITFA-related bills in the 107th Congress, the NGA continued to vocally advocate such a state-centered solution to the Internet tax issue. In March 2001, former Wyoming Governor Jim Geringer testified before the Senate Commerce, Science, and Transportation Committee touting an interstate compact known as the Streamlined Sales Tax Project that was being considered and adopted by a number of state legislatures throughout the country. On behalf of the NGA, Governor Geringer suggested to the Committee that the issue was not whether the Congress should allow states and local governing bodies to tax, but whether the Congress should enable such actions. In his view, and in the view of the NGA, the answer was "yes" (NGA Senate Testimony, March 14, 2001a).

In three letters in the summer of 2001, the NGA again laid out its preference for a state-based solution to Internet sales taxation. In particular, they expressed their preference for a uniform method through which states could collect sales tax on Internet purchases, and cited the fact that a substantial number of states had already enacted uniform streamlined sales tax laws that would assist in such collection. In that letter, the NGA lent its support to H.R. 1410, particularly the provisions of the bill that would have assisted the states in collecting sales taxes through an interstate compact (NGA Letter to the House, July 27, 2001b). The governors also pointed to a potential double standard by noting that the federal government, by collecting excise taxes on online purchases of liquor and cigarettes and taxes on online purchases of airline tickets, was unfairly imposing restrictions on the states that it was not imposing upon itself. In the latter two letters that summer, the NGA stated its support of S. 512 for many of the same reasons it supported H.R. 1410 (NGA Letter to Senate, July 27, 2001c; NGA Letter to Senate, July 27, 2001d).

By September 2003, the governors addressed Congress in a letter stating that the governors were no longer opposed to an extension of the moratorium, but that they were interested in congressional action that would allow the interstate compact to move forward (NGA Letter to House and Senate, September 17, 2003). The letter was in response to legislation, H.R. 2526, which would have made the moratorium permanent. The shift in language is notable in that it represented a move from outright opposition to the moratorium to a more pronounced support for the interstate compact. Throughout 2003, the NGA continued to support legislation to develop the Streamlined Sales Tax Project further. During that congressional session, S. 150 was introduced. An amended version of that bill was advanced toward the end of 2004. That legislation called for a moratorium of three years, though it did remove the sales tax exemptions that were originally left untouched by the 1998 law. Senate Bill 150 eventually was adopted and became public law in December 2004, placing a moratorium on Internet sales taxes until November 2007. In 2007, another extension was adopted (Public Law No: 110-108) that extended the moratorium through 2014.

In the end, complete agreement among the states on the need for a state-based solution to restrictions on Internet sales taxation could not be reached. As described above, the NGA acting as an organization representing the states provided a relatively cohesive front in its efforts to resist the ITFA put in place by Congress. However, as indicated by the positions of individual governors, this cohesion did not necessarily exist among individual governors. Of course, there are a number of reasons for why this may be. First, partisan differences may have hindered the ability of the NGA and its attendant governors to come to complete agreement on the policy. Indeed, because the issue of Internet taxation is so tightly bound to the highly contentious issue of taxation broadly considered, it is likely that partisan divisions detrimentally impacted the efforts of the NGA. Second, the telecommunications lobby within each state is influential, but likely has differential influence across the states. That is, such interests may have a major presence in certain states, such as Amazon, Inc. has in Washington State, but have relatively little power in other states. Under these conditions, it is likely that some governors would be more sympathetic to the wishes of the telecommunications than others, thereby leading to differing levels of support among governors for taxes to be levied on Internet sales and activities.

Interstate Agreement: The Streamlined Sales Tax Project

As described in detail above, various governors, working through the NGA, have sought congressional approval for an interstate compact related to Internet sales taxation. Interstate compacts are contracts between two or more states creating an agreement on a particular policy issue, adopting a certain standard or cooperating on regional or national matters (Zimmerman 2002). The purpose of interstate compacts is to allow states to act collectively, with the blessing of Congress, to address or pursue various policy goals; most interstate compacts therefore require congressional approval to take effect. However, interstate agreements and uniform laws allow states to adopt laws in a uniform way such that it is not necessary to implicate the federal government (Zimmerman 2002). This is precisely the goal of the Streamlined Sales Tax Project.

While all states have not conformed to the uniform laws put forth by the Streamlined Sales Tax Project, a large number of states have modified their statutes to become part of the agreement. In fact, by January 2011, 20 states had become full members of the compact, while four had become associate members, and another 18 had become advisory members. Thus, only a few of the states with a sales tax had not become a member by that date. The goal of the compact is to "find solutions for the complexity in state sales tax systems that resulted in the U.S. Supreme Court holding (*Bellas Hess v. Illinois and Quill Corp. v. North Dakota*) that a state may not require a seller that does not have a physical presence in the state to collect tax on sales into the state" (Streamlined Sales Tax Governing Board 2011a, 2011b). As Section 102 of the Streamlined Sales and Use Tax Agreement notes, "it is the purpose of this Agreement to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance" (Streamlined Sales and Use Tax Agreement 2010).

In order to unify the tax codes of the various states as they relate to Internet purchases, the agreement asks member states to codify various restrictions on the sales tax. For instance, "A member state that has local jurisdictions that levy a sales or use tax shall not have more than one local sales tax rate or more than one local use tax rate per local jurisdiction. If the local jurisdiction levies both a sales tax and use tax, the local rates must be identical" (Streamlined Sales and Use Tax Agreement 2010, Sec. 308 A). Further, "When the sale is sourced pursuant to this section to the location where the order is received by the seller, only the sales tax for the location where the order is received by the seller may be levied. No additional sales or use tax based on the location where the product is delivered to the purchaser may be levied on that sale. The purchaser shall not be entitled to any refund if the combined state and local rate or rates at the location where the product is received by the purchaser is lower than the state where the order is received by the seller" (Streamlined Sales and Use Tax Agreement 2010, Sec. 310.1 C). It is through such mechanisms that the Streamlined Sales Tax Project aims to standardize tax collection procedures across the states, thereby addressing one of the major concerns of the Supreme Court and Congress as it relates to Internet sales taxation.

Similar to other efforts by organizations to impact governmental policy, the move toward the adoption of interstate agreements is a complex undertaking that requires high levels of collective action at different levels of the policymaking process (Olson 1965). First, in this particular case, a governing body must outline the necessary steps and procedures for each state to become a member. This involves incorporating bylaws and devising a board of directors to guide the efforts of the compact. Second, high levels of collective action are needed at the state level. That is, in order for a state to become a full member, it must propose and adopt legislation and regulatory rules that meet the criteria set by the governing board of the interstate compact. Of course, legislation involves passage by a legislature and approval from a governor. In regulatory matters, executive agencies must coordinate, all the while attending to legal constraints that may or may not be set by the state and federal courts on the matter. In sum, the move to adopt policies congruent with the interstate compact involves a number of complex steps, which, in turn, require time and sacrifice on the part of the governing bodies responsible for adopting such laws.

Indeed, it appears that the hurdles to collective action on the matter are great enough that as of November 2011 only 21 states are full members of the compact, meaning that each has amended statutes and rules in accordance with the compact's rules. The fact that fewer than half of the states have taken the effort to amend their rules suggests that the desire to devise a streamlined Internet sales tax regime is modest. Again, this could be due to the same factors that kept the states and governors from fully agreeing on whether to lobby Congress for the ability to devise a solution to the Internet sales tax problem. Namely, there may be partisan differences among the states, and variations in industry presence among the states may account for part of the decision to join or not to join the interstate agreement.

Discussion

On its face, the current relationship between the state and federal governments on this issue seems to be consistent with theories of coercive federalism (Kincaid 1990; 2001) and perhaps regulatory federalism (Zimmerman 2010). That is, federal action has limited the states' ability to fully administer an Internet sales tax, and has been unwilling to address the concerns of the governors and the states as they relate to Internet sales taxation. Moreover, Congress has not given ground on potential interstate compacts on the issue. As such, the pattern of behavior by both state and federal governments is consistent with coercive federalism. However, a closer and more detailed look at the matter suggests that a new pattern of behavior may be emerging as states have begun to slowly modify their laws to be consistent with the Streamlined Sales Tax Project. This suggests that traditional cleavages between the states and the federal government on the issue may be giving way to a new relationship that is not necessarily captured by conventional theories or interpretations of federalism in the United States. In particular, state resistance to federal policy on the matter and state efforts to devise an interstate agreement dedicated to the development of an extra-congressional mechanism through which to collect Internet sales taxation may represent a willingness on the part of the states to use their sovereignty and constitutional authority to devise policies that directly contradict federal policy. It appears that there are two facets of the Internet sales tax issue that illustrate the ways in which the state–federal relationship has played out, and which will provide insight into possible future encounters between the state and federal governments, should critical questions surrounding the proper roles of each level of government again arise.

The Internet Sales Tax as an Opportunity for Intergovernmental Lobbying

As the states were repeatedly handcuffed by Congress through its implementation of an Internet sales tax moratorium, the states, represented primarily through the NGA, fought to resist the policies of the federal government on the matter. From 1998 up to 2004, the NGA repeatedly lobbied Congress on the issue of Internet sales taxation (in addition to other matters related to e-commerce) by writing letters to appropriate committees and congressional members, and by providing testimony to Congress on the matters related to Internet sales taxation. As noted, not all states and governors were in agreement on the extent to which—or whether—states should have the authority to place sales taxes on e-commerce. Indeed, the lack of agreement among the governors may have hindered the NGA's efforts to impact policy (Herian 2011). In light of research on the ability of intergovernmental lobbying organizations to impact federal policy (Smith 2008), however, this lack of agreement is not entirely surprising.

While we know that the NGA lobbies on a wide range of issues, its efforts on the Internet sales tax moratorium are notable for two reasons. First, in many of its efforts to affect federal policy related to Internet sales taxation, the governors used very forceful language that evoked many of the philosophical arguments and disagreements that have existed since the drafting of the U.S. Constitution. For example, signaling its initial stance on the issue, the NGA said, "Since adoption of the U.S. Constitution, Congress has generally respected state sovereignty with regard to state taxes. It is essential that the federal government not preempt, either directly or indirectly, sources of state revenues, state tax bases, or state taxation methods" (NGA Policy Position EC-09). The NGA used similarly strong language in a 1999 letter to Congress: "The proposed expansion of the moratorium contained in S. 1611 represents a major assault on state sovereignty. The levy of sales and use taxes is an inviolable right of the states" (NGA Letter to Senate, October 7, 1999b). These quotes are just two of many messages that have characterized Congress's decision to place a moratorium on taxes as a violation of constitutional principles. It is notable that the NGA generally did not question the legality of the moratorium, rather, the governors tended to question its ethics.

Second, the NGA's efforts in this policy domain have differed from their more standard efforts to influence policy in such areas as Medicare, Medicaid, welfare, the National Guard, etc. This is primarily because, unlike those other policies that originate at the federal level but have direct impacts upon state spending, the moratorium preempted the states from exercising a constitutionally protected state power: collecting sales taxes. Thus, the governors went beyond more standard approaches by being more forceful in its dealings with Congress since it was their view that state prerogatives were being violated. Once again, because the Internet sales tax and the related moratorium are relatively new policy developments, the governors had much room in which to work. Indeed, by using such strong language in the new policy domain, the governors surely hoped to help establish policy equilibrium on the issue (Baumgartner and Jones 1993).

The Internet Sales Tax as an Opportunity for Interstate Cooperation

The creation of an interstate compact was also made more likely by the fact that the Internet sales tax issue was a relatively unsettled policy domain. While others (e.g., Scheppach and Shafroth 2008) have actually advocated for the development of such policy alternatives as an interstate compact to deal with the Internet sales tax issue, it is possible that the creation of the Streamlined Sales Tax Project was a natural response to the policies of the federal government, rather than a concerted, conscious effort on the part of the states to devise alternative policy regimes to deal with the realities of the twenty-first century.

Regardless of whether the development of the interstate agreement was intentional or whether it was organic, it surely represents a policy innovation developed by the states. Again, interstate agreements, particularly compacts, typically involve relatively small numbers of neighboring or regional states that come together to address very practical needs of the member states. The Streamlined Sales Tax Project, in contrast, represents a broad-scale effort to develop an interstate compact among all states that currently levy a sales tax. As such, the compact represents a very ambitious, innovative effort to organize the activities of the states toward a common aim. Of course, other coordinated efforts among the states have also taken place. These efforts include innovations designed to deal with the Electoral College, the Real ID Act, recently adopted healthcare reform (Affordable Care Act), and interstate insurance regulation in the late 1990s. But, again, the Streamlined Sales Tax Project is distinct in that it represents an effort by the states to shape the contours of debate in a somewhat unsettled area of policy in the face of federal obstruction.

Nonetheless, it is notable that the Streamlined Sales Tax agreement has only 21 full members; 60 percent of the states have not joined the agreement. Clearly this has hampered the ability of the agreement to take effect, and leads to questions about *why* relatively few states have chosen to become part of the effort, particularly when this situation is in contrast to state activity with regard to the Gramm–Leach–Blilely Act of 1999 where states were able to come together to pass uniform laws in response to federal action. It is difficult to point to possible reasons for why states were able to act cohesively in that instance but not in the current effort to develop an interstate agreement for Internet sales taxation. Potential explanations include the fact that the industry was heavily involved in developing the state-centered solution for the Gramm–Leach–Blilely Act (Zimmerman 2010), while industry is, for the most part, resistant to the idea of being involved in the application and collection of Internet sales taxes. Additionally, the ideological and partisan aspects of Internet sales taxation may be hampering state efforts on the interstate agreement.

Conclusion: The Future of e-Commerce and Intergovernmental Relations

In such disparate policy areas as education, healthcare, national defense, and homeland security, the federal government has consistently pursued its policy priorities at the expense of the states in recent decades. Indeed, federal limitations on state Internet sales taxation seem to fit this overall pattern of the coercive relationship between the two levels of government. Recently, however, we have seen increased state activity in response to federal policies—such as in response to recent healthcare legislation, or in response to perceived federal inactivity such as with state policies designed to curb illegal immigration. In short, states have not sat idly by while the federal government has chosen to address certain challenges within the federal system while ignoring others. Indeed, the lobbying efforts of the NGA and the states, and efforts to develop an interstate agreement are primary illustrations of recent trends at the state level. It is critical that students of federalism recognize this important development to reflect on current theories of federalism, and as they attempt to devise new theories that more accurately reflect contemporary circumstances.

But while the intent of the states may be to resist federal efforts to limit taxing authorities, it appears that there may be limitations to the vehicle that the states are using to achieve their policy goals. The efficacy of the interstate agreement that is the goal of the Streamlined Sales Tax Project will only be a viable option for the states if all states eventually become part of the agreement. As noted previously, interstate agreements and compacts require high levels of coordination and collective action among the states, and it looks as though it will be an uphill battle for the proponents of the interstate agreement in its current form. Thus, it is necessary to recognize the potential limitations of the methods states are using even as one recognizes that (a portion of) the states are undertaking a very ambitious endeavor in their efforts to claim authority in a critical emerging policy area. It is particularly important to consider the limitations of an interstate agreement that is directly dependent upon governmental actions at the state level, where high levels of partisanship may limit efforts related to taxation, and where high levels of interest group activity in states with a high telecommunication industry presence may hinder the ability of states in joining the agreement.

Because of the unsettled nature of the policy domain, it is quite possible that state-centered solutions will eventually carry the day. If so, the relationship between the states and the federal government on e-commerce may need to be characterized by something other than the dominant federalism-related theories and perspectives that currently dominate the literature. Indeed, the situation may call for the need to move past static notions of coercive federalism, to recognize that even in the face of federal dominance on many issues, the states continue to innovate and, as in this particular case, prepare to take the lead in addressing pressing needs related to effective governance. Perhaps other conceptualizations such as dynamic federalism (Engel 2006) would more accurately capture the way in which states have recently approached this critical policy issue.

Commercial use of the Internet has only been prevalent for about 15 years. Internet sales taxation has only been a national policy issue for an even shorter period of time. Within this short time frame, the states have put forth considerable efforts to affect federal policy, while at the same time devising state-centered solutions to the concerns of the federal government. Consequently, even though coordination has eluded the states on the interstate agreement to this point, it appears that the states may actually be at the forefront of any potential reforms that do take place in the policy domain, and their efforts to develop an interstate compact may preempt, or at the very least guide, the policy efforts of the federal government into the future. As a result, the development of an interstate agreement on the issue has the potential to shift considerably the current policy equilibrium if it were to receive the necessary approval from Congress, or if a considerable proportion of the states actually revised their laws to accord with the interstate agreement currently in existence.

To paraphrase Conlan and Posner (2008), the capacity of the intergovernmental system will be tested as technological and cultural changes continue to unfold. In the domain of e-commerce, the philosophical disagreements between state and federal governments on the issue of Internet sales taxation, coupled with the critical need for states to be able to collect revenue in a period of fiscal austerity, ensures that the states will continue to be involved in the policy domain moving forward. It is important to recognize that current state-level activities have the potential to set a precedent for future situations in which state-level capacity to generate revenue is directly related to technological advances, but that may also potentially be limited by federal regulations. The rapid advance of technology suggests that such developments might take place quickly.

References

Baumgartner, Frank R., and Bryan D. Jones. 1993. *Agendas and Instability in American Politics*. Chicago: University of Chicago Press.

Broder, David. 2001. "Governors Still Possess Clout." *Express Times* (Easton, PA), March 5, 2001.

Broder, David. 2003. "New Leader Takes Over Vexed NGA: Organization is Split by Partisan Conflicts." *The Washington Post*, August 20, 2003.

Cammisa, Anne Marie. 1995. *Governments as Interest Groups: Intergovernmental Lobbying and the Federal System*. Westport, CT: Praeger.

Conlan, Timothy J. 1998. *From New Federalism to Devolution: Twenty-five Years of Intergovernmental Reform*. Washington, DC: Brookings.

Conlan, Timothy J. 2008. "Between a Rock and a Hard Place: The Evolution of American Federalism." In *Intergovernmental Management for the 21st*

Century, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 26-41.

Conlan, Timothy J., and Paul L. Posner. 2008. "Intergovernmental Management and the Challenges Ahead." In *Intergovernmental Management for the 21st Century*, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 1-9.

Engel, Kirsten H. 2006. "Harnessing the Benefits of Dynamic Federalism in Environmental Law." *Emory Law Journal* 56: 159-188.

Grodzins, Morton. 1960. "The Federal System." In *Goals for Americans: The Report of the President's Commission on National Goals*. Englewood Cliffs, NJ: Prentice Hall, 265-282.

Herian, Mitchel N. 2011. *Governing the States and the Nation: The Intergovernmental Policy Influence of the National Governors Association*. Amherst, NY: Cambria Press.

Kearney, Richard C., and Reginald S. Sheehan. 1992. "Supreme Court Decision Making: The Impact of Court Composition on State and Local Government Litigation." *Journal of Politics* 54 (4): 1008-1025.

Kettl, Donald F. 2003. "Innovation Freeze." *Governing Magazine*, October, p. 12.

Kincaid, John. 1990. "From Cooperative to Coercive Federalism." *The Annals of the Academy of Political and Social Science* 509: 139-152.

Kincaid, John. 2001. "Devolution in the United States: Rhetoric and Reality." In *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union*, eds. Kalypso Nicolaidis and Robert Howse. Oxford: Oxford University Press.

Macmahon, Arthur W. 1955. "The Problem of Federalism: A Survey." In *Federalism Mature and Emergent*, ed. Arthur W. Macmahon. New York: Doubleday, 3-27.

Nathan, Richard P. 2008. "Updating Theories of Federalism." In *Intergovernmental Management for the 21st Century*, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 13-25.

Olson, Mancur. 1965. *The Logic of Collective Action: Public Goods and the Theory of Groups*. Cambridge, MA: Harvard University Press.

Posner, Paul L. 2007. "The Politics of Coercive Federalism in the Bush Era." *Publius: The Journal of Federalism* 37: 390-412.

Posner, Paul L. 2008. "Mandates: The Politics of Coercive Federalism." In *Intergovernmental Management for the 21st Century*, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 286-309.

Regan, Priscilla M., and Christopher J. Deering. 2009. "State Opposition to REAL ID." *Publius: The Journal of Federalism* 39 (3): 476-505.

Sanford, Terry. 1967. *Storm Over the States*. New York: McGraw-Hill.

Scheppach, Raymond C., and Frank Shafroth. 2008. “Intergovernmental Finance in the New Global Economy: An Integrated Approach.” In *Intergovernmental Management for the 21st Century*, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 42-76.

Smith, Troy E. 2008. “Intergovernmetnal Lobbying: How Opportunistic Actors Create a Less Structured and Balanced Federal System.” In *Intergovernmental Management for the 21st Century*, eds. Timothy J. Conlan and Paul L. Posner. Washington, DC: Brookings, 310-337.

Streamlined Sales Tax Governing Board. 2011a. “About Us.” http://www.streamlinedsalestax.org/index.php?page=About-Us (accessed May 2, 2011).

Streamlined Sales Tax Governing Board. 2011b. “Streamlined Sales Tax and Use Agreement.” http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%2012_13_10.pdf (accessed May 3, 2011).

Vadum, Matthew. 2000. “State and Local Finance: Two More Republican Governors Lock Horns Over Internet Taxation.” Bond Buyer, 3 February 2000.

Wheare, K.C. 1964. *Federal Government*. Fourth Edition, New York: Oxford University Press, 4-5.

Wright, Deil. 1988. *Understanding Intergovernmental Relations*. Third Edition, Pacific Grove, CA: Brooks-Cole.

Zimmerman, Joseph F. 2002. *Interstate Cooperation: Compacts and Administrative Agreements*. Westport, CT: Praeger.

Zimmerman, Joseph F. 2010. “Generating Economic Growth by Harmonizing State Regulatory Laws.” Paper Presented at the *American Political Science Association Annual Meeting*, September 2010. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1642037## (accessed September 2011).

NGA Letters and Testimony

National Governors Association. 1999a. “Letter to All Senators Opposing Any Amendment to the Senate Version of the Tax Bill to Extend the Three-Year Moratorium on the Internet Tax Freedom Act Last October.” July 29, 1999. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=85fc9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 1999b. "Letter to Senator Lott and Senator Daschle Opposing Any Efforts to Extend the Duration or Expand the Scope of the Moratorium Imposed by the Internet Tax Freedom Act." October 7 1999. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=4bac9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2000a. "Testimony by Michigan Governor John Engler before the Senate Budget Committee on Internet Taxation in the New Millennium." February 2, 2000. http://www.nga.org/portal/site/nga/menuitem.0f8c660ba7cf98d18a278110501010a0/?vgnextoid=3eae9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2000b. "Letter (from NGA, NCSL, CSG, NACo, USCM, and ICMA) to the Senate Commerce Committee Opposing the Wyden Bill That Would Delay the Creation of a Level Playing Field." June 13, 2000. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=3bec9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2000c. "Letter From NGA (Council of State Governments/Council of State School Officials/e-Fairness Coalition/International Mass Retail Association/National Retail Federation/Real Estate Roundtable) to Members of the United States Senate Urging Them to Support the Voinovich-Dorgan Legislation to Extend the Internet Tax Freedom Act Moratorium and to Authorize the States to Enter Into an Interstate Compact to Simplify State and Local Sales and Use Tax Systems and Create a Level Playing Field." July 27, 2000. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=ed7c9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2001a. "Testimony by Wyoming Governor Jim Geringer Before the Senate Commerce, Science, and Transportation Committee on Extension of the Internet Tax Freedom Act and Legislation Establishing a Procedure That Would Encourage States and Localities to Continue Their Initiative to Develop and Implement a Simplified and Streamlined Tax System." March 14, 2001. http://www.nga.org/portal/site/nga/menuitem.0f8c660ba7cf98d18a278110501010a0/?vgnextoid=34be9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2001b. "Letter to Chairman Barr and Rep. Watt in Support of H.R. 1410 to Extend the Current Internet Tax Moratorium and Provide for a Level Playing Field." July 27, 2001. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=8dfd9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2001c. "Letter to Senator Baucus and Senator Grassley in Support of S. 512 to Extend the Current Internet Tax Moratorium and Provide for a Level Playing Field." July 27, 2001. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=69fd9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2001d. "Letter to Senator Hollings and Senator McCain in Support of S. 512 to Extend the Current Internet Tax Moratorium and Provide for a Level Playing Field." July 27, 2001. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=7bfd9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).

National Governors Association. 2003. "Letter (from NGA, NCSL, CSG, NACo, USCM, and ICMA) to Chairman McCain, Senator Hollings, Chairman Sensenbrenner, and Rep. Conyers Expressing Concern that while State and Local Government Officials Do Not Oppose the Moratorium on State and Local Taxation of Internet Access, Language to Extend the Moratorium to Certain Telecommunications Services is Too Broad and Could Result in Significant Revenue Losses for State and Local Governments." September 17, 2003. http://www.nga.org/portal/site/nga/menuitem.cb6e7818b34088d18a278110501010a0/?vgnextoid=c5fb9e2f1b091010VgnVCM1000001a01010aRCRD (accessed April 2011).