Objectives of this Proposal

- Minimize audit burden on merchants.
- Create records that are hard to falsify without detection.
- Make effective audits consistent with nexus standards.
- Meet unique requirements of information products (software, digitized music, text, ...)

Effective Third Parties for E-Commerce Taxation

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National Conference of State Legislatures (NCSL) Meeting
Chicago, June 2000
Difficulties with Information Products

• Deterring tax evasion is especially difficult.
  – Since a product can be sold many times, inventory
    records cannot corroborate sales records.
  – Since products are transferred over the Internet,
    which leaves no trace, shipping records and phone
    records cannot corroborate sales records.

• Determining the appropriate tax authority and
  tax rate is difficult.
  – With no shipping address, it is often impossible to
    determine the location of the buyer.

According to the
Streamlined Sales Tax System
Business and Technology Models

“the CSP can
  – calculate the tax due,
  – remit the tax to the appropriate state,
  – file a return with the appropriate state, and
  – maintain a record of the transaction.”

These functions are separable.
It should be possible for a third party to provide
any of these functions, all of these functions,
or any subset of these functions.
Basic Proposal

• Third parties should perform tax calculation.
  – Use of this function should be voluntary.
  – Merchants will do so to avoid liability for incorrect calculation.

• Third parties should transfer funds to correct state.
  – Use of this function should be voluntary.
  – Merchants will do so to reduce costs.

• Third parties (called notaries) should create trustworthy records.
  – Use of this function should be mandatory.

Notaries Create Trustworthy Records

• Merchant submits records for all transactions to notary, regardless of location of buyer.
  – To insure compliance, merchant is subject to possible audit by its state, and only its state.

• Third-party “notary” stores transaction record, and merchant identifier.
  – in a form such that subsequently altering or deleting a record would be detectable to an auditor.
  – Notaries are subject to audit from all states.
Using Encryption as a Tool

It is technically feasible to

– prove whether records have not been altered.
– conduct basic audit of notaries over the Internet
  • Instead of using computer hardware and software that you hope is tamper-proof, store information in view of auditors.
– do this without compromising privacy of consumers or merchants.

These valuable technologies will not be used unless it is a requirement for certification.

Benefits of Notaries

• Useful for taxation.
  – Trustworthy records for interstate purchases.
  – Merchants not subject to audit from remote states.
  – Simpler audits.

• Trustworthy “proof of purchase” records could also serve other purposes.
  – Protect consumers from fraud (false claims, ...)
  – Protect merchants from fraud (lack of payment ...)
  – Show whether all consumer warnings, warranties, etc. were delivered to consumer.
Determining Buyer’s Address with Information Products

- Another third party, a verifier, can authenticate the identity of a buyer, and then provide the location of that buyer’s home.
  - Note: this may not be the same as the location of the buyer at the instant of the purchase.

- Verifiers can check other credentials too, e.g.
  - whether buyer is officially tax exempt.
  - whether buyer is old enough to purchase liquor.

- These functions need not undermine privacy
  - e.g. a verifier can reveal buyer’s home state and not reveal buyer’s name.

Summary of This Proposal

- Merchants should be required to use third-party notaries to keep trustworthy records.
  - All states can audit the notary.
  - A state cannot audit a merchant without nexus.

- Merchants should be allowed to use one or more third parties for tax calculations, funds transfers, or both.
  - A third party can decide which services to offer.

- Verifiers can provide buyer location information when there is no other source.
Some Criteria to Evaluate Proposals

- If a merchant or third party alters or “loses” transaction records, could an auditor tell?
- Can merchants avoid onerous audits, or audits by remote states?
- Can most audits of third parties be conducted over the Internet? (Important because third parties are subject to audit by many states.)
- Would tax law allow the possibility of anonymous purchases?
- Will the system function as well with information-based products? (e.g. software or digitized music)

No Technology Risks

- We have designed a system that can achieve all of these goals.
- Despite claims from some stake-holders, if the policy is carefully crafted, there are no insurmountable technical barriers.
- When the policy is in place, the systems will follow.