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From Long Arms to Log Jams: Applying Age-old Legal Principles in Cyberspace

Every day it becomes more certain that the Internet will take its place alongside the other great transformational technologies that first challenged, and then fundamentally changed, the way things are done in the world."

Louis V. Gerntener, Jr.
CEO, International Business Machines (IBM)

"The question of jurisdiction over Internet activity is, in fact, a series of related questions about civil and criminal judicial jurisdiction and choice of law … ."

Allan R. Stein,
Symposium on Jurisdiction and the Internet

"Determining a taxable presence within a country or state may be a perilous proposition."
Kyrie E. Thorpe, "International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?," 11 Emory Int'l Law Rev. 633, 647-649 (1997)

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I. Jurisdiction: Business in the Brik-and-Mortar Era

From the brick-and-mortar era grew a time-honored and important legal principle: jurisdiction. In everyday parlance, the term "jurisdiction" carries many meanings. But when the term is broken down it can be viewed two ways. The concept of "general" jurisdiction refers to the authority of a court to hear all claims against a given defendant, regardless of the connection of the claim to the forum in question.[1] The concept of "specific" jurisdiction, on the other hand, refers to the court's authority jurisdiction over a defendant for the limited purpose of adjudicating claims that have some "important connection to the forum."[2] The concept of jurisdiction pervades all areas of law, including commercial law.

With respect to "specific jurisdiction" and a court's ability to exercise jurisdiction over defendants, defendants were historically required to reside in the same State. That is, a defendant's physical presence within the territorial jurisdiction of the court was a prerequisite to the court's rendering of a judgment.[3] The rationale is that the jurisdiction of courts to render judgment in personam was grounded on the courts de facto power over a defendant's "person." This standard of physical presence extended to commercial law, as well.

In a commercial context, laws concerning jurisdiction stood on the premise that such laws were tantamount to stability and predictability, both of which are presumably necessary for a vibrant marketplace.[4] But as commercial transactions began to cross state lines – and country lines, for that matter – our courts were forced to realize that modern transportation and expedient modes of communication effectively made it much less burdensome for a party to defend itself in another State."[5] The continuous evolvement of this phenomenon was, and remains to be, a result of the ongoing transformation of the American economy.[6]

The concept of jurisdiction is rooted deeply in American law. In fact, it flows from the dictates of the Due Process Clause of the Fourteenth Amendment of the United States Constitution. In this context, the Fourteenth Amendment limits the power of a state court to render a valid personal judgment against a nonresident defendant.[7] This safeguard gives a degree of predictability to the legal system, allowing potential defendants to structure their conduct with some assurance as to where that conduct may or may not render a defendant liable to a lawsuit.[8]

The function of due process in this regard operates not only as a function of an "individual liberty" interest, but also to restrict state power.[9] In effect, individuals should not be subject to the binding judgments of a forum with which he or she has no meaningful "contacts, ties, or relations."[10] To this end, judgments rendered in violation of due process are void in the rendering State and not entitled to full faith and credit elsewhere.[11]

II. Jurisdiction: Personal Jurisdiction and "Purposeful Availment"

From a defendant's perspective, the protection from inconvenient litigation is typically described in terms of "reasonableness" or "fairness."[12] In 1945, the United States Supreme Court addressed this issue and determined that, pursuant to the dictates of due process, a court may subject a nonresident defendant to a judgment in personam only if the defendant has "certain minimum contacts" with the foreign jurisdiction – so that maintenance of the suit does not offend the notions of "fair play and substantial justice."[13] The Supreme Court echoed its own holding thirty-five years later.[14] In World-wide Volkswagen, the court reasoned that the concept of "minimum contacts" protects a defendant against the burdens of litigating in distant or inconvenient fora, as well as to ensure that states do not reach beyond the limits imposed on them by their status as "coequal sovereigns in federal system."[15]

In 1985, the Court in Burger King Corp. v. Rudzewicz,[16] built upon the foundation lain in International Shoe and World-wide Volkswagen, improved the "minimum contacts" standard, and held that jurisdiction cannot be avoided if a defendant has "purposefully availed" himself of the privilege of doing business in another forum, even if the defendant neither resides in, nor entered, the forum State. Under Burger King Corp., the central question thus became: Did the defendant "purposefully established minimum contacts?"[17] If so, a court may exercise jurisdiction over a nonresident defendant.

This is the heart of the due process analysis and it rests on two cornerstones: "foreseeability" and "voluntariness." Pursuant to this principle, it is assumed that a defendant will not be haled into a foreign court solely as a result of "random, fortuitous, or attenuated" contacts.[18] Thus, once it has been decided that a defendant purposefully established minimum contacts with the forum State, these contacts may be considered in light of other factors to determine whether the assertion of personal jurisdiction comports with the notions of "fair play and substantial justice."[19]

States do not exceed their power when they assert jurisdiction over corporations that deliver their products into the "stream of commerce," when corporations expect that their products will be purchased

by consumers in the forum State.[20] A classic case is when a publisher distributes magazines in a distant State. In such cases, publishers may be held accountable in that forum for resulting damages – such as in cases of defamation.[21]

To facilitate exercising jurisdiction over nonresidents, many States enact so-called "long-arm statutes," the essence of which permits States to exercise jurisdiction over nonresidents. For instance, the State of Florida's long-arm statute extends jurisdiction to "[a]ny person, whether or not a citizen or resident of this State, who … breaches a contract in this State by failing to perform acts required by the contract to be performed in this State … ."[22]

It should be noted, however, that an individual's contract with an out-of-state party cannot, alone, establish sufficient minimum contacts in the other party's home forum. In fact, prior contractual negotiations and contemplated future consequences, along with the terms of a contract and the parties' actual course of dealing, may be enough for a court to conclude that a defendant "purposefully established minimum contacts" within a foreign State. But if a defendant, who purposefully directed his activities at the forum residents, seeks to defeat jurisdiction, he must present a compelling case that the presence of some other considerations would render jurisdiction unreasonable.[23]

A look at a hypothetical example may be helpful: Suppose Hobo Bill, a New Jersey "resident," found a flyer on the ground, which "Steve's Sweet Compact Discs," a New York, company had placed into the stream of commerce a month earlier. The flyer reads, "Come To Any Steve's Location, Buy One Blank Cassette Tape, and Get 'The Best of Tom Jones' FREE."

Suppose further that after having a friendly passer-by read the flyer to him, Hobo Bill borrowed a dollar from the good samaritan and took an Academy bus from Paterson, New Jersey, to Jersey City, New Jersey, to take advantage of this offer. Suppose further still that the compact disc, which Hobo Bill eventually claimed, had been damaged during shipment to Steve's, and that Hobo Bill did not realize this until he left the store. In light of this scenario, and in the event that Steve's should not honor its warranty and Hobo Bill decide to sue Steve's Sweet Compact Discs – a New York company – in the Morris County Superior Court, Law Division (a New Jersey court), it is extremely likely that the Superior Court of New Jersey would exercise jurisdiction over Steve's, in light of Steve's "contacts" with New Jersey.[24]

III. Choice of Law

Upon a proper finding of personal jurisdiction, a court is then forced to contemplate choice-of-law issues; that is, courts must decide which State law applies to the case at hand. This is important because laws can vary significantly among states. If a State court applies the substantive law of state A, rather than state B, the result of the case may be completely different. The process of choosing which law to apply is procedural in nature and is traditionally made without regard to the substance of the laws in question.[25]

When contractual disputes arose in the brick-and-mortar era, courts were free to apply any number rules to resolve such questions. For instance, the Restatement Conflict of Laws (First Restatement) was the first primary reference for choice of law decisions in the United States. Under this approach, courts focused on the geographic location of the place where the contract was formed.[26] The State in which a contract was executed would be the State whose laws would usually apply. As time went on, this rationale was eroded and replaced. The "most significant relationship" analysis emerged, which was followed by the "interest analysis"[27] approach, which, in turn, was followed by the "center of gravity" test.[28]

Before the brick-and-mortar world drew to a close, substantial disagreement continued to exist among the courts with respect to choice-of-law methodology. While one State utilized the "interest analysis," another utilized the "center of gravity" test. The inconsistency, which with our courts addressed choice-of-law conflicts, transcends not only the boundaries between States, but also the boundaries between eras, too.

Today, electronic commerce ("E-commerce"), which is arguably conducted as much "everywhere" as it is "nowhere," presents a direct challenge to traditional legal concepts, concepts which were imperfect even during the brick-and-mortar era. No clearly definable boundaries exist in Cyberspace; thus, how does one apply the tenets and standards of jurisdiction? A closer look at how the Internet is constructed helps to distinguish the rigidity of the brick-and-mortar world from the seemingly indefinable parameters of "Cyberspace."

IV. The Internet

A. Amorphous Topography

In 1962, a series of memoranda written by J.C.R. Licklinder of the Massachusetts Institute of Technology (MIT) described a "Galactic Networking" concept, in which society could interact electronically.[29]

Licklinder envisioned a globally interconnected set of computers through which people could quickly access data and programs from any location.[30]

Apparently, MIT was fertile ground for such innovative thinking, for in 1964, Leonard Kleinrock published the first book on "packet switching," which argued for the theoretical feasibility of communications using packets rather than circuits while networking electronically.[31] In effect, packet switching breaks down information to be sent into small "packets" and labels each packet with the same address. The information is then sent to the destination, but each packet may take a different route.[32]

This concept was followed-up in 1865, when MIT researcher Lawrence G. Roberts connected the TX-2 computer in Massachusetts to the Q-32 in California, whereby Roberts communicated with Thomas Merrill. This accomplishment effectively created the first, however small, wide-area computer network.[33] It established that time-shared computers could work well together, running programs and retrieving data on a remote machine; however, it also established that circuit switched telephone systems were entirely inadequate in this capacity, confirming Kleinrock's proposition for the need for packet switching.[34]

Due to Kleinrock's early development of packet switching theory, his network center at UCLA was selected to be the first "node" on the ARPANET, and in the fall 1969, the first computer host at UCLA was installed.[35] One month later, the first host-to-host message was sent from Kleinrock's laboratory at UCLA to the second node on the ARPANET, which was located at Stanford Research Institute. Then, one by one, more computers were added to the ARPANET, thus establishing what would soon become the Internet – an open-architecture network, composed of individual networks that can be designed in accordance with the specific environment and user requirements of that network.[36]

B. "Physical" and "Logical" Network Infrastructures

Today, the Internet is a comprehensive network of thousands of computer networks, located throughout the world.[37] In basic terms, the Internet is composed of two main components: the physical network infrastructure and the logical network infrastructure.[38] The physical network infrastructure refers to the actual physical parts that comprise the Internet, such as cables, wires, and modems.[39] The logical network infrastructure can be viewed as the code that "governs the movement of traffic down the network highways" and refers to the process by which information moves throughout the network.[40] Combined, these two structures make the Internet operate.

The Internet operates as a result of electronic information passing from one place to another.[41] As stated earlier, when sending information, computers break down the information into small "packets" and label each packet with the same address. The information is then sent to the destination, but each packet may take a different route.[42]

When information is sent over the Internet, a series of interactions occur between and among various components of the physical and logical infrastructures.[43] As to the physical infrastructure, components known as "routers" and "servers" play a significant role. Routers are analogous to post offices, in that they recognize the destination addresses of the packets passing through them and forward the information on to a specific route; servers, on the other hand, are computers that function as depositories that store information that is available for access by users of a network, including the Internet.[44]

The logical infrastructure is responsible for transferring and sending information. Its most significant attribute is that is operates on a "domain name system," which associates true numerical destination addresses with easier-to-remember address names for the user. In other words, rather than having to look up and remember a series of numbers for Montclair State University's Web site, the Internet user can simply type http://www.montclair.edu. Thus, an Internet user need not know the numerical address of a site and need only to type the "word" address, which the logical infrastructure automatically translates into the numerical address.[45]

As stated earlier, the Internet is only one part of the "Information Superhighway," which actually includes many forms of electronic communication, ranging from telephone lines to satellites.[46] When compared to traditional methods of communication, one of the many differences with respect to the Internet is that there is often no identifiable sender of information. As we will see when we merge conventional notions of jurisdiction with Cyberspace, significant problems arise with respect to allocating jurisdiction in Cyberspace.

V. E-commerce: Opportunity and Conundrums

The Internet opened the door to a new frontier, one no less significant than the Industrial Revolution: The Information Age. The Internet is amorphous and nebulous in nature, and because it operates with virtually any form of digital information, it was not long after the Internet was discovered that companies and individuals began engaging in electronic commerce ("E-commerce").

By virtual definition, E-commerce transactions transcend the borders of states and countries. Generally, E-commerce refers to all forms of commercial transactions, which involve both organizations and individuals and which results from the processing and transmitting of information, data, text, and audio and visual images.[47] E-commerce is broken down into various types, such a business-to-business and business-to-consumer. While engaging in E-commerce, businesses have the potential to improve greatly their market efficiencies by dealing directly with their business partners in other jurisdictions, having little or no need for middle persons.[48] The explosive growth of E-commerce prompted President Clinton to deem the Internet the "Wild West" of the global economy.[49]

E-commerce transactions often cross state and international borders and are thus subject to a quagmire of conflicting national and local laws and regulations. As such, the global, amorphous nature of the cyberspace presents many problems for current judicial system, because the laws governing E-commerce transactions are new or non-existent; and as such, jurisprudential interpretation is nascent and undeveloped.[50]

Take the earlier hypothetical regarding Hobo Bill, only alter it a bit so as to place the hypothetical scenario in the context of Cyberspace. That is, suppose Hobo Bill logged on to a personal computer at the Morristown Public Library (New Jersey), the server for which is actually located in New York. Suppose further that Hobo Bill accessed the innovative Web site for Steve’s Sweet Compact Discs (www.sweetdiscs.com),[51] the server for which is located in New Jersey. And, oh sure, suppose further that Hobo Bill utilized a stolen credit card to purchase "The Best of Tom Jones" over an electronic order form, the attached contract for which contained neither a reference to jurisdiction nor a choice-of-law provision. Once complete, the order was then routed to a central processor, which is located in neither New York nor New Jersey (but rather, Connecticut) where Hobo Bill’s credit card number is processed – unbeknown to Steve’s Sweet Compact Discs. Upon approval, the order is shipped to the Morristown Post Office. This hypothetical is replete with examples that beg one fundamental question: Where did the transaction occur?

Did the transaction occur in New Jersey, where Hobo Bill logged onto the personal computer and where Steve’s sweet server is located? Or did it occur in New York, the State in which Steve’s is headquartered and in which the server for Hobo Bill’s personal computer is located? Clearly, the very nature of Cyberspace makes answer questions of jurisdiction extremely difficult, and if Hobo Bill were to initiate a lawsuit in New Jersey Superior Court, Law Division, the court would undoubtedly have a more difficult

time exercising jurisdiction. The case of People ex rel. Vacco v. World Interactive Gaming Corp., 1999 WL 591995 (N.Y.Sup., July 29, 1999), helps to illustrate this point.

People ex rel. Vacco v. World Interactive Gaming Corp., is a case that concerns gambling by New York residents over the Internet. The central issue in Vacco is whether the State of New York can enjoin a foreign corporation, which was legally licensed to operate a casino offshore from offering gambling to Internet users in New York.

In Vacco, the Attorney General of the State of New York (the "Attorney General" or the "State of New York"), sought, inter alia, to enjoin the respondent, World Interactive Gaming Corporation ("WIGC"), from operating within or offering to residents of the State of New York State gambling over the Internet. Section 9(1), Article 1 of the New York State Constitution contains an express prohibition against any kind of gambling not authorized by the State legislature. The prohibition represents a deep-rooted policy of the state against unauthorized gambling.[52]

WIGC is a Delaware corporation that maintains corporate offices in New York, and also wholly owns an Antiguan subsidiary, which acquired a license from the government of Antigua to operate a land-based casino. Through contracts executed by WIGC, the subsidiary developed interactive software and purchased computer servers, which were installed in Antigua to allow users around the world to gamble from their home computers. GCC promoted its casino on its Web site, advertised on the Internet, and in a national gambling magazine. The promotion was targeted nationally and was viewed by New York residents.

On the GCC Web site, users who wished to gamble in the GCC Internet casino were directed to wire money to open a bank account in Antigua and download additional software from GCC's Web site. In opening an account, users were asked to enter their permanent address. A user who submitted a permanent address in a state that permitted land-based gambling, such as Nevada, was granted permission to gamble. Although a user who entered a state such as New York, which does not permit land-based gambling, was denied permission to gamble. But because GCC’s software did not verify the user's actual location, a user who might have been denied access initially could easily circumvent the denial by changing the state entered to that of Nevada, while remaining physically in New York State. The user could then log onto the GCC casino and play virtual slots, blackjack, or roulette. According to the court in Vacco, this practice raised the question if this constitutes a good faith effort not to engage in gambling in New York.

In response to the action brought by New York, the respondent moved to dismiss the petition on the grounds that, among other things, the Attorney General for the State of New York, lacked the authority to exercise personal jurisdiction over WIGC and its Antiguan subsidiary. The respondent contended that the transactions occurred offshore and that no state or federal law regulates Internet gambling. WIGC claimed that it was operating a duly licensed legitimate business fully authorized by the government of Antigua and in compliance with that country's rules and regulations of a land-based casino. WIGC further argued that the federal and state laws upon which New York relied either did not apply to the activities of WIGC or was too vague and ambiguous to criminalize the activity of Internet gambling, when such activity is located offshore in Antigua.

With respect to the issue of personal jurisdiction over WIGC and its subsidiary, the Vacco court noted that, although Internet transactions may appear novel, "traditional jurisdictional standards have proved to be sufficient to resolve all civil Internet jurisdictional issues."[53] The court went on to note, "What makes Internet transactions shed their novelty for jurisdictional purposes, is that similar to their traditional counterparts, they are all executed by and between individuals or corporate entities which are subject to a court's jurisdiction."[54]

Whether the exercise of personal jurisdiction comports with due process requirements depends, as in any case, upon a finding that the respondent has purposefully engaged in significant activities such that he "availed himself" of the privilege of conducting business in the forum State.[55] "The test," the Vacco court stated, "is the aggregate of the corporation's activities in the State such that it may be said to be "present" in the State, "not occasionally or casually, but with a fair measure of permanence and continuity."[56]

The Vacco court ruled that WIGC and its Antiguan subsidiary were clearly doing business in New York. Although WIGC was incorporated in Delaware, WIGC operated its entire business from its corporate headquarters in Bohemia, New York. All administrative and executive decisions, as well as the computer research and development of the Internet gambling Web site, were made in New York. WIGC's continuous and systematic contacts with New York established their physical presence in New York.[57]

Furthermore, the Vacco court went on to note that, even without physical presence in New York, WIGC's activities were sufficient to meet the minimum contact requirement of International Shoe. For instance, WIGC worked in conjunction with another New York-based company Imajix Studios, to design the

graphics for their Internet gambling casino, and from their New York corporate headquarters, Imajix Studios downloaded, viewed, and edited their Internet casino Web site. Moreover, WIGC engaged in an advertising campaign all over the country to induce people to visit their Web site and gamble. Knowing that these ads were reaching thousands of New Yorkers, WIGC made no attempt to exclude identifiable New Yorkers from the propaganda. Phone logo from respondents' toll-free number (available to casino visitors on the GCC Web site) indicated that respondents had received phone calls from New Yorkers.

In short, the court ruled that the respondent could not dispute that it did business in New York – and that the acts complained of are subject to this court's jurisdiction.[58] For this and other reasons, the Vacco court granted New York injunctive relief, and required WIGC to post a bond "assure future proper behavior."

VI. Taxation of E-commerce: Jurisdictional Problems

As is clearly evident, the growth of the Internet – and Internet E-commerce – has created a frontier filled with opportunity, yet one wrought with legal complexities. Interestingly, one of the most vexing legal issues that flow from the Internet – aside from jurisdiction itself – is not a new problem, but rather an age-old concept: taxation. The question of taxation of E-commerce flows from the same fundamental question that plagues issues of jurisdiction: Where did the transaction occur.

This fundamental question is important because, historically, most states and countries impose taxes on companies based on either a "residence" principle or a "source" principle.[59] That is, if a government establishes that a company is a "resident" of that country or state – or if the "source" of that company's income was derived from within the country's borders – that government may "fix" a legal right to tax that company's income.[60] The concept of residency is grounded in the "permanent establishment" principle.[61] Residency requirements are usually connected to some sort of geographic or physical presence in a country or state.[62]

Yet, even if a company fails to establish residency in a jurisdiction, the controlling government may still be able to impose taxes on the company's income if it is determined that the "source" of the company's income is derived from within the country's borders. Most countries maintain that the source of a company's income is the country in which the economic activities generating the income occur. It is generally accepted that "source of income" principles have priority over residency rules, and the country

of origin has the right to tax income. Most taxing authorities around the world have adopted these rules.[63]

When the brick-and-mortar tax principles of yesteryear are set against the amorphous, borderless topography known as Cyberspace, it is quickly discernable that the Internet and E-commerce present extraordinary challenges to traditional concepts of taxation. Governments are faced with new challenges to their tax administrations, for in this new frontier, the Internet has no physical location, users do not control it, and, generally, no one knows the path along which information travels.[64]

This changing business environment has spurred differing ideologies with respect to tax collection. On the one hand, free-market libertarians argue that online retail sales should be out of reach of the Cybertax Man; on the other hand, state and local officials view the Internet and E-commerce as a "tide that will erode local and regional tax bases with devastating consequences," as more and more sales move from traditional brick-and-mortar retailers to Cyberspace.[65] Therefore, lawmakers, legal practitioners, regulators, international organizations, and other fora have had no choice but to place the issue of Internet taxation on their agenda.

Yet, developing workable systems of taxation is easier said than done. For this reason, the United States Congress took a deliberate, cautious, contemplative approach to the Issue of taxing the Internet, by deciding not to tax it – or at least for the short term. On October 21, 1998, Congress signed into law the Internet Tax Freedom Act ("ITFA").[66]

VII. The Internet Tax Freedom Act: A Three-year Moratorium

In passing the ITFA, Congress sought to protect the Internet, its information, and the commerce that flows from it, as well as to create further stimulus to this dynamic medium. By way of the ITFA, Congress imposed a three-year moratorium on certain types of taxes related to the Internet. The moratorium contemplates two types of taxes related to the Internet and encourages Congress to engage in a worldwide initiative to remove tariffs and discriminatory taxes from E-commerce.

1. No Taxes on Internet Access

Under Section 1101(a)(1), federal, state, and local governments are barred from taxing Internet access. Internet access is "any service that enables users to access content, information, electronic mail, or other

services offered over the Internet." (11 U.S.C.A. § 1104(5).) In simple terms, this means that the $19.95 that many Americans pay per month for America Online cannot be taxed.

2. No Multiple Taxation

In general, this section covers taxes that may be levied in an unfair manner, particularly in instances where two or more taxing jurisdictions tax the same service. Whether two or more taxes are "multiple" is considered independent of whether they are levied at the same rate or on the same basis.[67] This section appears to strengthen the protections already afforded by the U.S. Supreme Court against multiple jurisdictional taxation.[68]

3. No Discriminatory Taxes on E-commerce

In the world of tax law, the phrase "discriminatory tax" typically carries a distinct meaning, one that is used to describe an unfair tax that favors local commerce over interstate commerce. In this context, however, Section 1104(2) uses the term "discriminatory" to capture instances where State or local tax policies intentionally or unintentionally place E-commerce at a disadvantage compared to similar commerce conducted through more traditional means. In other words, a tax is discriminatory if it is imposed on an Internet transaction, but not on any similar transactions off the Internet.

When read in pari materia, Section 1104(2)(B)(i) and Section 1104(2)(B)(ii) appear to suggest that Congress considers the creation or maintenance of an Internet site to be so insignificant a physical presence that the use of an in-State computer server by a remote seller should not be considered in determining nexus. The two sections also prohibit a State or political subdivision from deeming an ISP an "agent" of a remote seller.

This section intends to prohibit States and local governments from using Internet-based contacts as a factor in determining whether an out-of-state business has a "substantial nexus" with a taxing jurisdiction. This Section seemingly attempts to provide additional assurance that "substantial nexus" continue to be the standard for taxation, a standard determined through a "bright-line" physical presence test.

4. Exception to Moratorium

Moratorium does not apply if a person "knowingly and with knowledge of the character of the material" makes any communication for commercial purposes that is available to any minor [under 17] and that includes "any material that is harmful to minors … ." The Act defines "material that is harmful to minors" as "any communication, picture, image, graphic image file, article, recording, writing, or other matter of any kind that is obscene or that (i) … is designed to pander to the prurient interest; (ii) depicts, describes, or represents … an actual or simulated sexual act or sexual contact …; and (3) … lacks serious literary, artistic, political, or scientific value for minors."

This exception does not apply if such person or entity has restricted access by minors to material that is harmful to minors in one of the following ways: (1) requiring use of a credit card, debit account, adult access code, or pin number; (2) by accepting a digital certificate that verifies age; or (3) by any other reasonable measures that are feasible under available technology. However, this exception does not apply to telecommunication carriers engaged in the business of providing Internet access.

5. International Cooperation

The ITFA declares that the U.S. considers the Internet to be a tariff-free zone. The ITFA calls on the executive branch to work closely with the EU and WTO to keep electronic commerce free from tariffs and discriminatory taxes. The ITFA declares that the United States should "assure that electronic commerce is free from (1) tariff and non-tariff barriers; (2) burdensome and discriminatory regulation and standards; and (3) discriminatory taxation. …"

VIII. Possible Solutions: A Few Tax Proposals

Some policy makers, legislators, and scholars believe that not to tax remote sales over the Internet is unfair to traditional brick-and-mortar business and puts them at a competitive disadvantage and potentially out-of-business. Others believe that it is not the role of policy makers to protect certain sectors of the marketplace; that, if consumers choose Internet-based sellers over traditional sellers, and the latter becomes insolvent, such is the result of healthy competition in the marketplace.[69] Still others believe that taxing the Internet is tantamount to regulating it.

In simple terms, tax systems specify who shall be taxed and what shall be taxed.[70] For most of the twentieth century, nations across the globe have been in agreement about the principles that guide taxation of international business transactions. These principles, whose main ideas were developed nearly

eighty years ago, are "enshrined today in over 1,000 substantially similar bilateral income tax treaties and a few internationally respected model treaties."[71] An example of one such treaty is enumerated in the Organization for Economic Cooperation and Development (OECD), Model Income Tax Treaty, the purpose of which is not only to prevent double taxation, but to prevent nontaxation as well.[72] To similar ends, various systems of taxation of E-commerce have been proposed. A few examples follow and conclude this discussion.

A. The Bit Tax

The "bit tax" is a tax on the "interactive digital traffic on the Information Superhighway.[73] The bit tax is the most controversial proposal thus far, because the tax would be applied to the "flow volume" of data, and then collected by telecom carriers, satellite networks, and cable systems and sent to governments.[74] Interestingly, in order to eliminate the possibility of double-taxation, the bit tax would only apply to value-added portions of interactive digital transactions. Arthur Cordell, creator of the bit tax proposal, sees interactivity as making the transaction valuable and taxable therefor.[75]

The main appeal of the bit tax is its ostensible simplicity: a specific tax rate is applied to the volume of interactive Cyberspace traffic. This, alone, is enough to make the bit tax proposal attractive to governments. However, such simplicity may be more apparent than real, for the bit tax proposal presents significant problems as to how to measure accurately measure the volume of data collections could either be inflated or deflated, which would result in unintended distortions in the tax base and instabilities in the tax system.[76]

By prohibiting the creation of new state, local, or federal taxes on Internet access or electronic commerce until October 2001, the ITFA effectuated a virtual time-out with respect to Internet taxation.[77] In effect, the moratorium gives policy makers time to evaluate the manner and mechanisms with which to tax E-commerce and the Internet. Nevertheless, policy makers will soon be faced with the obligation of fulfilling a mandate, which brings with it a demand to go beyond mere rhetoric and dire warnings and to explore workable solutions to what some believe is an obvious conclusion: Countries, states, and municipalities should be able to tax Internet sales.[78] The question, however, still remains "how?"

B. Software Solution

This proposed solution uses technology to implement fairness and uniformity. Under this theory, which was advanced by Robert D. Atkinson and Rudolph H. Court,[79] a created organization (perhaps the Federation of Cybertax Administrators) would "contract out" to develop software that contained the state and local sales tax rates on all categories of items for all state and local tax districts in the nation. Retailers would then download the free "shareware" software over the Internet.

When a consumer effectuates a transaction over the Internet, the software would "check" the tax rates in the jurisdiction to which the consumer instructs the merchandise to be shipped and apply the tax rate accordingly. If the consumer orders intangible merchandise, the tax would be determined according to the consumer's home or business address. (This, of course, presumes myriad methods of verification of address and residence.) In the end, the software would then display the tax rate along with all other charges, as on any traditional receipt, and the customer would pay the full amount.

The software would include routing numbers for each sales tax jurisdiction bank account, and the merchant's software would automatically transfer the sales tax funds via electronic funds transfers directly to the government bank account(s). For instance, as Atkinson and Court point out,

If a merchant collected $600 in sales tax from residents in a particular county in a particular state, where the state sales tax is four percent and the local is two percent for a total tax of six percent, the software would remit $400 to the state's bank account (along with an electronic form that lists the merchant's name and other pertinent information), and $200 to the county bank account.[80]

A system like this allows tax rates to continue to fluctuate over time; however, in under this approach, the tax software in question would need to be updated regularly, to reflect new tax rates. And retailers, too, would need to regularly download the most current tax rates into their programs.

C. The European Proposal: The Value-Added Tax

In the European Union, ground has already been broken with regard to a system of taxing E-commerce. The European Union already has a system known as value-added tax ("VAT") in place, and is now working to apply it to E-commerce. The VAT is a form of consumption tax, and is the simple largest source of tax revenue for all country members of the Organization Economic Cooperation and Development (OECD). Under this plan, software manufacturers would be required to devise a method to

keep track of E-commerce sales. Banks would then process the transactions, withhold taxes from the sales, and pass the proceeds onto the appropriate government within the European Community.

Under VAT, banks would offer this service for a fee to clients, and national governments would help banks defray part of the collection costs. Yet, in order to adhere to the principle of tax neutrality, the European Union has proposed classifying E-commerce goods ("virtual goods") as services. This distinction is important because, under VAT, the European Union taxes differently; that is, current VAT legislation requires the sales of services within the European Union to be taxed, but provides that sales of services outside of the European Union would not be taxed. Consequently, the sale of "virtual goods" as services would fall victim to the same delineation, meaning that the sale of goods over the Internet for consumption outside of the European Union would be subject to the VAT tax. The centerpiece of this proposal is that it comports peacefully with the principles of tax neutrality, "with minimal disruption expected for most of the world's current tax regimes."

As presently framed, banks play a significant role in the EU VAT plan. This raises several troublesome issues. One issue is that banks are not governmental agencies, nor are they pseudo-governmental agencies. In effect, banks would have an incentive to increase the volume of E-commerce to garner greater fees from the taxes collected from the volume of E-commerce transactions. This increases the likelihood for fraud in the handling of tax disbursement of tax revenues by banks.

Another problem is the difficulty associated with banks accurately and timely allocating tax funds to governments. In other words, different banks from different regions have different turnaround times in disbursing tax funds, which, in turn, could create timing expectation problems for countries that are reliant on consumption taxes for their tax base. Of course, an international agency could be created to monitor the activities of banks, but such resource and jurisdictional problems could be difficult to surmount.

D. The Clinton Administration Proposal

The Clinton Administration proposed a high-tech variant of the traditional VAT tax. Under this proposal, consumers would purchase digital cash cards (known as "smart cards," or "e-cards") at banks that allow the seller to identify the country from which the purchase was made. The VAT would be calculated, based upon the place of consumption, and immediately collected with the sale. The seller would then place the funds with a third party escrow agent, who would funnel the money to the appropriate

government.[81] Like the European plan, the Clinton plan is tax-neutral. The Clinton plan also involves the creation of an escrow agency, which centralizes the funneling of tax revenues to appropriate governments through an escrow agent.[82]

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[1] In the context of "specific jurisdiction," the term "forum" refers to the State in which an action has been brought against a defendant.

[2] Arthur Von Mehren & Donald Trautman, "Jurisdiction to Adjudicate: A Suggested Analysis," 79 Harv. Law Rev. 1121, 1136-63 (1966). See also, Restatement (Second) Conflict of Laws Ch. 3, Introductory Note, (1971) ("If a court's jurisdiction is based on its authority over the defendant's person,

the action and judgment are denominated 'in personam' … . If jurisdiction is based on the court's power over property within its territory, the action is called 'in rem' or 'quasi in rem.'")

[3] International Shoe Co. v. State of Washington, Office of Unemployment Compensation and Placement, 326 U.S. 310, 316 (1945).

[4] Richard A. White, "Overcoming Regulatory Barriers to Successful E-commerce," 570 PLI/Pat 703 (1997).

[5] World-wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 293 (1980).

[6] 444 U.S. at 293.

[7] Kulko v. California Superior Court, 436 U.S. 84, 91 (1978).

[8] See 471 U.S. at 472.

[9] Id. at note 3.

[10] International Shoe Co., 326 U.S. at 316.

[11] See id.

[12] See id.

[13] Id.

[14] See 444 U.S. 286 (1980).

[15] Id. at 292.

[16] 471 U.S. 462 (1985) (wherein franchisor, a Florida corporation, brought an action against franchisee, a Michigan resident, alleging breach of franchise obligations and trademark infringement).

[17] Id. at 474.

[18] Id.

[19] 326 U.S. at 320.

[20] See 444 U.S. 297-298.

[21] See Keeton v. Hustler Magazine, Inc. 465 U.S. 770, 774 (1984).

[22] Fla. Stat. § 48.193(1)(g)(Supp. 1984).

[23] 471 U.S. at 477.

[24] This hypothetical presupposes that no difference exists between Hobo Bill's finding the flyer and his receiving a flyer via the mail. Of course, a stronger argument exists for "purposeful availment" if the contact, minimal or otherwise, had been made directly between Steve's and Hobo Bill, rather than Hobo Bill finding the advertisement as a third party.

[25] See id.

[26] See First Restatement, note 214.

[27] See Gary B. Born, "International Civil Litigation in the United States Courts," at 680 (1996).

[28] The "interest analysis" approach considers which State has a more compelling interest in the transaction at hand; the "center of gravity" test allows a court to look at all of the "significant factors" that might logically influence the decision of which law to apply. Under the "center of gravity" test, a court will apply the substantive law of the State with the most significant connection to the transaction or the parties in the case. See generally, Auten v. Auten, 308 N.Y. 155, 124 N.E. 99 (1954).

[29] Barry M. Leiner, "A Brief History of the Internet," Internet Society (ISOC) All About the Internet accessed May 30, 2000; available from http://www.isoc.org/internet-history/brief.html

[30] Id.

[31] Id.

[32] Id.

[33] Id.

[34] Id.

[35] Id.

[36] Id.

[37] See Carl W. Chamberlain, "To the Millennium: Emerging Issues for the Year 2000 and Cyberspace," 13 Notre Dame J.L. Ethics & Pub. Pol'y 131, 145 (1999).

[38] Kyrie E. Thorpe, "International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?," 11 Emory Int'l L. Rev. 633, n. 12 (1997).

[39] Howard E. Abrams & Richard L. Doernberg, "How Electronic Commerce Works," 14 Tax Notes Int'l 1573, 177-81 (1997.

[40] Kyrie E. Thorpe, "International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?," 11 Emory Int'l L. Rev. 633, 640 (1997).

[41] Id.

[42] Id.

[43] Id.

[44] Id.

[45] David R. Johnson & David Post, "Law and Borders -- The Rise of Law in Cyberspace," 48 Stan. Law Rev. 1367 (1996).

[46] See Richard D. Pomp & Oliver Oldman, State and Local Taxation, Second Edition, Volume II, Chapter Twelve (12): The Taxation of Electronic Commerce (1997), 1073.

[47] See Dept. of the Treas., Off. Of Tax Policy, Selected Tax Policy Implications of Global Electronic Commerce, § 7.2.3. (Nov. 1996) (http://www.ustreas.gov/taxpolicy/internet.html).

[48] See Douglas Lavin, "Outlook: Why E-commerce and the Euro Will Pack a Punch," Wall St. J. Europe, Sept. 7, 1998, at 18.

[49] See "Information Technology: Administration to Negotiate in WTO for Internet Trade Free of Barriers," 14 Int'l Trade Rep. (BNA) No. 28, at 1178 (July 9, 1997).

[50] See Steven R. Salbu, "Who Should Govern the Internet?: Monitoring and Supporting a New Frontier," 11 Harv. J.L. & Tech. 429, 461 (1998) (proposing that a global, unified approach is the best approach to solving the legal issues associated with the ever-expanding Internet).

[51] The author of this work does not represent that www.sweetdiscs.com is a functioning Web site.

[52] See Intercontinental Hotel Corp. v. Golden, 18 A.D. 2d 45 (1st Dept. 1963).

[53] People ex rel. Vacco v. World Interactive Gaming Corp., 1999 WL 591995 (N.Y. Supp., July 29, 1999) at 3 (citing People v. Lipsitz, 174 Misc. 2d 571, 578 (Sup. Ct. New York County 1997)).

[54] See id.

[55] Id. (citing Burger King Corp. v. Rudzewicz, 472 U.S. 462, 475-476 (1985)).

[56] Id. (citing Laufer v. Ostrow, 55 N.Y.2d 305, 310 (1982); Tauza v. Susquehanna Coal Co., 220 N.Y. 259 (1917).

[57] See id.

[58] The Vacco court also exercised personal jurisdiction over WIGC's Antiguan subsidiary, because WIGC "dominated or controlled" the daily activities of the subsidiary (citing Dalagi v. Volkswagenwerk, 29 N.Y.2d 426 (1972) and Taca International Airlines, S.A. v. Rolls-Royce of England, Ltd., 15 N.Y.2d 97 (1965)).

[59] Clayton W. Chan, "Taxation of Global E-commerce on the Internet: The Underlying Issues and Proposed Plans," 9 Minn. J. Global Trade 233, 248 (Winter 2000).

[60] William C. Benjamin and Michael J. Nathanson, "Conducting Business Using the Internet: Gauging the Threat of Foreign Taxation," 9 J. Int'l Tax'n 29, 30 (1998).

[61] Clayton W. Chan, "Taxation of Global E-commerce on the Internet: The Underlying Issues and Proposed Plans," 9 Minn. J. Global Trade 233, 248 (Winter 2000) (quoting Kyrie E. Thorpe, "International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?," 11 Emory Int'l Law Rev. 633, 647-649 (1997)).

[62] See id. at 248 (quoting Kyrie E. Thorpe, "International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?," 11 Emory Int'l Law Rev. 633, 647-649 (1997)).

[63] See James D. Cigler and Susan E. Stinnett, "Treasury Seeks Cybertax Answers with Electronic Commerce Discussion Paper," 8 J. Int'l Tax'n 56, 58 (1997).

[64] Daniela Ivascanu, "Legal issues in Electronic Commerce in the Western Hemisphere," 17 Ariz. J. Int'l & Comp. L. 219, 243 (Winter 2000).

[65] Robert D. Atkinson & Randolph H. Court, "Internet Taxation: A Software Solution," 5 Va. J.L. & Tech. 1 (2000).

[66] The Omnibus Appropriations Act of 1998 was signed into law on October 21, 1998, of which Section 1100, et seq., "The Internet Tax Freedom Act" ("ITFA"), is a part. The ITFA enacted no "effective" section and is still referred to as P.L. 105-277.

[67] The ITFA defines "multiple tax" as "any tax that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof … without a credit … for taxes paid in other jurisdictions."

[68] See Goldberg v. Sweet, 488 U.S. 252 (1989) (wherein the Court held that to double-tax the interstate telephone call, the interstate telephone call must originate or terminate in the State and must be billed to an in-State address in order for that State to tax the telephone call).

[69] Robert D. Atkinson and Rudolph H. Court, "Internet Taxation: A Software Solution," 5 Va. J.L. & Tech. 1, 10 (2000).

[70] Barret Schaefer, "International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-based Taxation," 16 Santa Clara Computer & High Tech. L.J. 111, 121 (1999).

[71] Id.

[72] Id.

[73] Clayton W. Chan, "Taxation of Global E-commerce on the Internet: The Underlying Issues and Proposed Plans," 9 Minn. J. Global Trade 233, 256 (Winter 2000)

[74] Id..

[75] Id.

[76] Id.

[77] It should be noted that, as of the writing of this paper, Congress is contemplating extending this moratorium beyond 2001.

[78] Robert D. Atkinson and Rudolph H. Court, "Internet Taxation: A Software Solution," 5 Va. J.L. & Tech. 1, 4 (2000).

[79] Id. at 18.

[80] Id. at 18-19

[81] Clayton W. Chan, "Taxation of Global E-commerce on the Internet: The Underlying Issues and Proposed Plans," 9 Minn. J. Global Trade 233, 261 (Winter 2000)

[82] Id.