E-Execs in Loophole Heaven

By David Ignatius

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For a depressing demonstration that the old politics of greed and self-dealing apply to the New Economy, consider the recent deliberations of the Internet tax commission, chaired by Virginia Gov. James Gilmore.

The commission was established by Congress 17 months ago to make recommendations about how the Internet and e-commerce transactions should be taxed. The Clinton administration and many independent experts hoped the commission would propose a clear plan to "level the playing field," so that the same tax rules would apply to all retailers. Right now, you have to pay sales tax if you buy a toaster from your local hardware store, but not if you buy it from an online merchant.

But the Gilmore commission is instead on the verge of endorsing a package of tax loopholes that would provide only a vague commitment in principle to future tax equity – and in the short run, would enrich the six companies whose executives serve on the 19-member commission. Even by the standards of Washington politics, this is a shabby story.

Last week, the commission, by an 11 to 8 vote, tentatively approved a proposal by the business members that would include, among other items, the following:

• A new sales tax exemption for online retailers that have brick-and-mortar "affiliates," giving them the same tax break as companies that operate entirely in cyberspace. This provision was supported by commission member Ted Waitt, who's chairman of computer seller Gateway Inc. Waitt recently turned Gateway's network of 240 stores into affiliates, making it easier for him to compete with rival Dell, which doesn't have a similar network around the country and thus doesn't have to collect sales tax. (Under existing law, a retailer must collect taxes in any state where it has a physical presence.)

• The "Gateway Giveaway," as Stanford economist Charles McLure caustically dubbed this provision, would be good for Waitt's company, but it would be bad for America. It would accelerate the rush to create phony "dot.com" sales channels, further undermine traditional brick-and-mortar retailers and gut the local tax base. But wait, there's more mischief . . .

• A new loophole to exempt from taxes all "digitized content" (things that can be sent electronically, such as music, e-books, online games and software) and their old-fashioned non-digitized counterparts. In other words, the commission would create a special tax exemption for books, music, electronic games, magazines and software. Gosh, even newspapers!

And guess who happens to sit on the commission? Why, none other than Robert Pittman of America Online and Richard Parsons of Time-Warner, presidents of two of the most powerful content companies in America--which after their planned merger would probably benefit most from this loophole.

Why should AOL-Time Warner's CDs get a special tax break, but not the Steinway piano or the Fender guitar that made the music? It defies logic--but that has been the pattern with the Gilmore commission. And wait, there's still more . . .

• A new tax break for telecommunications companies and their customers, repealing the 3 percent federal excise tax that's now charged on telephone calls. And who were among the disinterested, public-spririted business leaders who endorsed this tax repeal? None other than Michael Armstrong, chief executive of AT&T, and John Sidgmore, vice chairman of MCI WorldCom. This proposal actually makes some sense--House Democratic leader Richard Gephardt backed it yesterday, for example--but it's undermined by the Gilmore commission's aura of log-rolling. And hold on, there's still more . . .

• A new loophole to exempt the local affilates of online concerns from paying state income tax, as well as sales tax. Among the biggest beneficiaries here would be banks, brokers and other financial companies that make big money through a combination of online operations and local branches. Inevitably, the Gilmore commission included a representative from one such concern--David Pottruck, president of Charles Schwab.

"Six pigs at the trough" is how one frustrated state representative characterized the business members of the Gilmore commission. But as it happens, they're not the most egregious offenders. Even worse have been the politicians, led by Gilmore himself, who have actually tried to dissuade some of the business members from even their vague endorsement last week of eventual tax equity between e-commerce and Main Street. Gilmore's anti-tax absolutism might have made sense when the Internet was in its infancy, but it's so big now it's practically swallowing the Old Economy. It hardly needs special protection.

Gilmore and his allies have been so shameless, in fact, that they're rewriting the commission's rules. Backed by a letter from Republican Senate and House leaders

Trent Lott and Dennis Hastert, Gilmore has ruled that the commission can issue its report with a simple majority, rather than the 13-vote "super majority" Congress had originally required when it created the commission in 1998.

The Gilmore commission has a last chance to avoid special-interest ignominy tomorrow, when the members are scheduled to hold a final teleconference. It would be nice to think that sanity might yet win out over greed and anti-tax zealotry, but don't bet on it. When high tech meets low politics, the pols rule.