

Law Chasing Technology

By Reg P. Wydeven
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Technology is being developed at an exponential rate today. Things we never thought were possible are now happening because of technology. The flying cars and colonies on the moon featured in many of the cartoons I watched as a kid can't be far off. And the creation of laws regulating these new technological breakthroughs won't be far behind.

Portable MP3 players, capable of downloading and playing thousands of digital music and now video files, are hugely popular, as evidenced by the near tripling of digital sales of music last year, from \$400 million in 2004 to \$1.1 billion worldwide in 2005.

Hoping to jump on the gravy train, 15 states currently tax the purchase of digital-media downloads, including music, movies and electronic books, and many more states are contemplating the move. These states are either drafting specific legislation authorizing the taxation of digital downloads, or are interpreting existing statutes to extend to downloaded purchases. Last year, Governor Doyle proposed a tax on Apple's iTunes purchases, however, the Joint Finance Committee voted not to include it in the budget.

The states claim there should be no distinction between the taxation of digital-media downloads and physical shopping – the taxpayer ends up with the same music whether they buy a CD at the store or download it online.

Another burgeoning Internet business is online lending. Chris Larsen, the founder of the online lender E-Loan that was sold last year for \$300 million, recently introduced Prosper.com. Prosper allows its users to lend money to and borrow money from other users at better interest rates than traditional financial institutions and without some of the risks of inter-personal loans.

Prospective investors register on Prosper and indicate how much they are willing to lend and their desired interest rate. Prospective borrowers then register with the site and Prosper reviews their credit history. The borrowers then post a loan request of up to \$25,000, along with a maximum interest rate they are willing to pay. The loans are not secured by collateral and are paid off over three years at a fixed rate, with no prepayment penalty.

Prosper then matches up potential lenders with the borrower and arranges one loan at a single rate. Prosper then establishes a monthly repayment system that withdraws money from the borrower's checking account. In the event of default, Prosper even hires a collection agency and alerts credit bureaus. Prosper prospers by charging borrowers 1% of the loan, while lenders pay 0.5% of the loan's balance each year.

While new to the U.S., this concept has caught on abroad. Britain's Zopa.com currently has more than 50,000 registered users, with about 15% of the users either lending or borrowing money at any given time.

The IRS will surely keep an eye on the growth of Prosper.com and other similar sites. The interest generated on these loans is taxable income, however, Prosper will only issue a 1099 when a user earns more than \$600 in interest, which would require at least a \$20,000 loan at 5%. Presumably there will be countless numbers of taxpayers lending smaller amounts that will have the onus of reporting the interest income themselves.

The IRS' grasp is far-reaching – I just wonder if those colonies on the moon will fall under its jurisdiction.