106TH CONGRESS, 2d Session | HOUSE OF REPRESENTATIVES | REPORT 106–609

INTERNET NONDISCRIMINATION ACT OF 2000

MAY 8, 2000.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. GEKAS, from the Committee on Judiciary, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 3709]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 3709) to make permanent the moratorium enacted by the Internet Tax Freedom Act as it applies to new, multiple, and discriminatory taxes on the Internet, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

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The amendments are as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Internet Nondiscrimination Act of 2000".

SEC. 2. 5-YEAR EXTENSION OF MORATORIUM ON STATE AND LOCAL TAXES ON THE INTERNET.

(a) EXTENSION OF MORATORIUM.—Section 1101 of title XI of division C of Public Law 105–277 (112 Stat. 2681–719; 47 U.S.C. 151 note) is amended—

(1) in subsection (a)—

(A) by striking "3 years after the date of the enactment of this Act" and inserting "October 21, 2006", and

(B) in paragraph (1) by striking ", unless" and all that follows through "1998",

(2) by striking subsection (d), and

(3) by redesignating subsections (e) and (f) as subsections (d) and (e), respectively.

(b) TECHNICAL AMENDMENT.—Section 1104(10) of title XI of division C of Public Law 105–277 (112 Stat. 2681–719; 47 U.S.C. 151 note) is amended by striking "unless" and all that follows through "1998".

SEC. 3. APPLICATION OF AMENDMENTS.

The amendments made by this Act shall not apply with respect to conduct occurring before the date of the enactment of this Act.

Amend the title so as to read:

A bill to extend for 5 years the moratorium enacted by the Internet Tax Freedom Act; and for other purposes.

PURPOSE AND SUMMARY

The Internet Nondiscrimination Act, H.R. 3709, extends for an additional 5 years the moratorium on internet access taxes and multiple and discriminatory taxes on electronic commerce imposed by the Internet Tax Freedom Act. It also eliminates the current exception to the moratorium on internet access taxes for selected States which had such taxes in place at the time of the enactment of that act.

BACKGROUND AND NEED FOR THE LEGISLATION

The Internet Tax Freedom Act, P.L. 105–277, created an Advisory Commission on Electronic Commerce for the purpose of conducting a thorough study of Federal, State and local, and international taxation of transactions using the internet and internet access. On April 12, 2000, the Commission submitted its report to Congress. While the Commission was able to make several formal findings and recommendations related to internet taxation[1], it did not achieve the two-thirds vote[2] necessary to do so on the core

[1] The report contains three formal findings and recommendations. These relate to (1) the digital divide; (2) privacy implications of internet taxation; and (3) international taxes and tariffs. *Report to Congress*, Advisory Commission on Electronic Commerce, April 2000, (hereinafter, Report) at 4. The Report may be viewed in its entirely on the Commission's web site, www.ecommercecommission.org.

[2] The Internet Tax Freedom Act provides that "No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission serving at the time the finding or recommendation is made." Section 1103, 47 U.S.C. 151 note.

issues pertaining to State sales and use taxes. However, as a result of the Commission's work, two competing proposals have emerged which address how the tax system in the United States should be adjusted so that both electronic commerce and Government can fulfill the roles required of them in the new economy. It is clear that Congress will have to spend time studying these proposals and hearing from interested parties before determining how best to proceed on this core issue—whether and how State and local taxing authorities should be permitted to collect taxes on transactions occurring over the internet.

Notwithstanding the Commission's inability formally to issue a recommendation on internet taxation policies, there is substantial unanimity that the current moratorium on taxes on internet access and multiple and discriminatory taxes on electronic commerce should be continued. The majority position,[3] which was discussed at length in the Report, includes these two proposals:

> Make permanent the current moratorium on any transaction taxes on the sale of internet access, including taxes that were grandfathered under the Internet Tax Freedom Act.
>
> For a period of 5 years, extend the current moratorium barring multiple and discriminatory taxation of e-commerce and prohibit taxation of sales of digitized goods and products and their non-digitized counterparts;

Report at 19 and 23.

The minority viewpoint similarly urges extension of the current moratorium:

> The temporary moratorium on transaction taxes on Internet access charges established in the Internet Tax Freedom Act (ITFA) should be extended.
>
> The temporary moratorium barring multiple and discriminatory taxes on electronic commerce should be extended for a period of time commensurate with the implementation of sales tax simplification efforts outlined below. Congress should then examine whether these provisions of the ITFA should be continued.

A Proposal for a Streamlined, Fair Tax System, submitted to the Advisory Commission on Electronic Commerce by Commissioners Jones, Kirk, Leavitt, Lebrun and Loche at 4.

In addition, the three administration representatives on the Commission (who were among those who abstained from voting on the majority proposal) wrote in their individual statement contained in the Report:

> 1. *No Internet Access Taxes*
>
> *The current statutory moratorium on Internet access taxes should be made permanent.*
>
> It is critically important to encourage access to the Internet. Because taxes on Internet access would create an obstacle to the access of all Americans to the Internet, and in turn, their ability to participate in electronic commerce these taxes should be prohibited permanently.

[3] The majority proposal was agreed to by a vote of 11 yeas, 1 nay, and 7 abstentions.

2. *No Multiple and Discriminatory Taxes*

The current statutory moratorium on multiple and discriminatory taxes should be extended.

Multiple or discriminatory taxes on electronic commerce plainly would hinder its development. The existing statutory moratorium should be extended, and final protections against such taxes should be crafted after the States develop simplified sales tax systems.

Report at 58.

THE CURRENT MORATORIUM

The 3-year moratorium enacted as part of the Internet Tax Freedom Act emerged from a debate that recognized the need to avoid stifling the potential for an innovative form of technology to provide information, goods, and services quickly and cheaply throughout the world. Congress also recognized, as did the Advisory Commission in its Report, that a major priority in addressing whether and how the internet should be subject to taxation should be reducing or removing barriers to access to perhaps the most advanced and useful medium of communications and commerce yet devised. These dual concerns led to two modest limitations on State and local taxation of the internet:

A. *No State or political subdivision may impose a tax on* internet access*, unless the tax was in place prior to enactment of the statute.*

At the time the ITFA was passed, 12 States and the District of Columbia asserted that they levied sales taxes on internet access. Since the moratorium's enactment, several of these States have reversed their policies on taxing internet access charges.[4] It is the committee's understanding that 10 States continue to impose internet access taxes pursuant to the grandfather clause:[5]

a. Connecticut—under the authority of Section 12–407(2)(i)(A) of the General Statutes of Connecticut, the State imposes a sales and use tax on internet access charges. However, this tax is scheduled to be completely phased out by July 1, 2001.

b. Montana—Title 15, chapter 53 of the Montana Code Annotated is a retail telecommunications excise tax which applies to retail sales of 2-way communications of voice, data or video, regardless of medium. This includes internet access services.

c. New Hampshire—The New Hampshire Communications Services tax, Revised Statutes Annotated (RSA) chapter 82–A, is a telecommunications excise tax which covers 2-way telecommunications services offered by certain types of providers, notably cable television system operators. Thus, it will apply to internet access charges imposed by cable companies.

[4] In 1999, Iowa enacted a law specifically exempting internet access charges from tax. In May 1999, the South Carolina Department of Revenue formally indicated that it would not impose taxes on internet access charges for the duration of the moratorium.

[5] The validity of many of the taxes enumerated here are currently the subject of legal challenge. For example, America Online, one of the largest internet access service providers in the State of Tennessee, has challenged the constitutionality of the State requirement that AOL collect sales taxes on internet access provided to customers in the State. During the pendency of the litigation, AOL has not collected the disputed tax. The Tennessee Department of Revenue estimates that the amount of revenue in dispute in this case is in excess of $10 million annually.

d. New Mexico—under the authority of New Mexico Statutes Annotated 7–9–3, internet access charges are subject to gross receipts taxes.

e. North Dakota—at the time of enactment of the Internet Tax Freedom Act, North Dakota had two taxes that applied to internet access charges—North Dakota Century Code 57–39.2 and 57–34. One tax was a telecommunication gross receipts tax; the other is a sales and use tax. The Board of Equalization of the State had ruled initially that internet access charges were included within the definition of telecommunications gross receipts to which that tax applied. However, effective in July 1999, the Board stopped enforcing the telecommunications tax on internet access, on the grounds that the legislative intent of the tax was unclear as to its scope. The sales and use tax continues to be applied to internet access charges.

f. Ohio—Chapter 5739 of the Ohio Revised Code subjects the business use of internet access to a sales and use tax.

g. South Dakota—South Dakota Codified Law Annotated 10–45–5 imposes a sales and use tax on internet access charges.

h. Tennessee—pursuant to Tennessee Code Annotated 67–6–221, 67–6–102(23)(iii), and 67–6–702(g), the State imposes a sales and use tax on internet access charges.

i. Texas—although under the Internet Tax Freedom Act the State would have been permitted to tax all internet access charges, it has chosen to exempt up to $25 per month of internet access fees from its sales and use tax. Texas Tax Code, chapter 151, section 151.325.

j. Wisconsin—sales and use taxes are imposed on internet access charges pursuant to Section 77.52(2)(a)5 of the Wisconsin Statutes (1995–96).

In addition, 16 cities in Colorado, including Wheat Ridge, Woodland Park, and Longmont, and the city of Tuscon, Arizona impose internet access taxes.

B. No State or political subdivision may impose a multiple or discriminatory tax on electronic commerce.

The Internet Tax Freedom Act defines electronic commerce as a transaction conducted over the internet or through internet access, comprising the sale, lease, license, offer or delivery of property, goods, services or information.

A multiple tax is a tax by one State or political subdivision on the same, or essentially the same, electronic commerce which is also subject to another tax by another State without allowing a credit for taxes paid in other jurisdictions. The limitation on multiple taxes would not prevent a State and one or more political subdivision from taxing the same transaction, but it would prevent the transaction from being subject to tax by competing States or localities. Thus, for example, a purchase made in Virginia from a seller in Maryland could be taxed by the State of Virginia and the county of Arlington. It could not also be taxed by Maryland, however, unless the a credit for the tax paid in Virginia were available.

A discriminatory tax is one that is imposed on a transaction occurring over the internet but not on non-internet transactions involving similar goods; one which taxes internet transactions at

rates higher than similar non-internet transactions; one which imposes the tax collection obligation for an internet transaction on an entity different than one involving a non-internet transaction; or one which taxes information providers at a higher rate when the information is delivered over the internet.

The definition of discriminatory tax also clarifies that certain types of contact with a taxing jurisdiction will be insufficient to establish "nexus" (the constitutionally required relationship between a taxing authority and the entity on which it seeks to impose a tax collection obligation). Under this provision, a taxing jurisdiction will not be able to require a seller to collect a tax on electronic commerce if:

(a) the sole ability to access a site on a remote seller's out-of-state computer server is a factor in determining the remote seller's tax collection obligation; or

(b) an internet service provider (ISP) is deemed to be the agent of a remote seller for determining tax collection obligations solely because of the display of a remote seller's information on the ISP's out-of-state computer server, or because it processes orders through an out-of-state computer server.

The current moratorium does not place any other restrictions on a State or local taxing authority's ability to impose a sales or use tax on a transaction that takes place over the internet.

EFFECT OF H.R. 3709 ON CURRENT LAW

As introduced, H.R. 3709 would have simply made permanent the current moratorium. The committee adopted an amendment in the nature of a substitute, offered by Mr. Goodlatte and Mr. Boucher, which instead extended its length by 5 years. If the bill is enacted, the moratorium will expire on October 21, 2006. The substitute amendment adopted by the committee also eliminates the grandfather clause which permits the collection of internet access taxes enumerated above.

HEARINGS

No hearings were held on H.R. 3709. However, in the 105th Congress, the committee's Subcommittee on Commercial and Administrative Law held a hearing on H.R. 1054, the "Internet Tax Freedom Act," which included a provision creating the moratorium which is the subject of H.R. 3709.

COMMITTEE CONSIDERATION

On May 4, 2000, the committee met in open session and ordered favorably reported the bill H.R. 3709 with amendment by a recorded vote of 29 to 8, a quorum being present.

VOTES OF THE COMMITTEE

There were three rollcall votes during committee deliberations on H.R. 3709. In addition, an amendment in the nature of a substitute by Mr. Goodlatte and Mr. Boucher which would extend the moratorium for 5 years and eliminate the grandfather clause was adopted by voice vote. The rollcall votes were as follows:

An amendment by Mr. Chabot to the Goodlatte/Boucher amendment in the nature of a substitute which would make the moratorium permanent and eliminate the grandfather clause. The amendment was defeated by a rollcall vote of 10 to 23.

ROLLCALL NO. 1

	Ayes	Nays	Present
Mr. Sensenbrenner	X		
Mr. McCollum	X		
Mr. Gekas	X		
Mr. Coble		X	
Mr. Smith (TX)			
Mr. Gallegly	X		
Mr. Canady		X	
Mr. Goodlatte		X	
Mr. Chabot	X		
Mr. Barr	X		
Mr. Jenkins		X	
Mr. Hutchinson		X	
Mr. Pease	X		
Mr. Cannon			
Mr. Rogan	X		
Mr. Graham	X		
Ms. Bono	X		
Mr. Bachus		X	
Mr. Scarborough			
Mr. Vitter		X	
Mr. Conyers		X	
Mr. Frank		X	
Mr. Berman		X	
Mr. Boucher		X	
Mr. Nadler		X	
Mr. Scott		X	
Mr. Watt		X	
Ms. Lofgren		X	
Ms. Jackson Lee		X	
Ms. Waters		X	
Mr. Meehan		X	
Mr. Delahunt		X	
Mr. Wexler			
Mr. Rothman		X	
Ms. Baldwin		X	
Mr. Weiner		X	
Mr. Hyde, Chairman		X	
Total	10	23	

An amendment by Mr. Delahunt to the Goodlatte/Boucher amendment in the nature of a substitute which would have extended the current moratorium for 3 years from the date of enactment, and which would have continued the grandfather clause. The amendment was defeated by a rollcall vote of 15 to 22.

ROLLCALL NO. 2

	Ayes	Nays	Present
Mr. Sensenbrenner		X	
Mr. McCollum		X	
Mr. Gekas		X	
Mr. Coble	X		
Mr. Smith (TX)		X	
Mr. Gallegly		X	

ROLLCALL NO. 2—Continued

	Ayes	Nays	Present
Mr. Canady		X	
Mr. Goodlatte		X	
Mr. Chabot		X	
Mr. Barr		X	
Mr. Jenkins	X		
Mr. Hutchinson		X	
Mr. Pease		X	
Mr. Cannon		X	
Mr. Rogan		X	
Mr. Graham		X	
Ms. Bono		X	
Mr. Bachus		X	
Mr. Scarborough		X	
Mr. Vitter		X	
Mr. Conyers	X		
Mr. Frank	X		
Mr. Berman	X		
Mr. Boucher		X	
Mr. Nadler	X		
Mr. Scott	X		
Mr. Watt	X		
Ms. Lofgren		X	
Ms. Jackson Lee	X		
Ms. Waters	X		
Mr. Meehan		X	
Mr. Delahunt	X		
Mr. Wexler	X		
Mr. Rothman	X		
Ms. Baldwin	X		
Mr. Weiner	X		
Mr. Hyde, Chairman		X	
Total	15	22	

Motion to report H.R. 3709 as amended by the amendment in the nature of a substitute. By a rollcall vote of 29 to 8, the motion to report favorably was agreed to.

ROLLCALL NO. 3

	Ayes	Nays	Present
Mr. Sensenbrenner	X		
Mr. McCollum	X		
Mr. Gekas	X		
Mr. Coble	X		
Mr. Smith (TX)	X		
Mr. Gallegly	X		
Mr. Canady	X		
Mr. Goodlatte	X		
Mr. Chabot	X		
Mr. Barr	X		
Mr. Jenkins		X	
Mr. Hutchinson	X		
Mr. Pease	X		
Mr. Cannon	X		
Mr. Rogan	X		
Mr. Graham	X		
Ms. Bono	X		
Mr. Bachus	X		
Mr. Scarborough	X		
Mr. Vitter	X		
Mr. Conyers		X	

ROLLCALL NO. 3—Continued

	Ayes	Nays	Present
Mr. Frank		X	
Mr. Berman	X		
Mr. Boucher	X		
Mr. Nadler	X		
Mr. Scott		X	
Mr. Watt		X	
Ms. Lofgren	X		
Ms. Jackson Lee		X	
Ms. Waters	X		
Mr. Meehan	X		
Mr. Delahunt		X	
Mr. Wexler	X		
Mr. Rothman	X		
Ms. Baldwin		X	
Mr. Weiner	X		
Mr. Hyde, Chairman	X		
Total	29	8	

COMMITTEE OVERSIGHT FINDINGS

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the committee reports that the findings and recommendations of the committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

COMMITTEE ON GOVERNMENT REFORM FINDINGS

No findings or recommendations of the Committee on Government Reform were received as referred to in clause 3(c)(4) of rule XIII of the Rules of the House of Representatives.

NEW BUDGET AUTHORITY AND TAX EXPENDITURES

Clause 3(c)(2) of House Rule XIII is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the committee sets forth, with respect to the bill, H.R. 3709, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, May 8, 2000.

Hon. HENRY J. HYDE, *Chairman,*
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed federal cost estimate and mandates statement for H.R. 3709, the Internet Nondiscrimination Act of 2000.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Mark Hadley (for federal costs), who can be reached at 226–2860, and Shelley Finlayson (for the state and local impact), who can be reached at 225–3220.

Sincerely,

DAN L. CRIPPEN, *Director.*

Enclosure

cc: Honorable John Conyers Jr.,
Ranking Democratic Member.

H.R. 3709—Internet Nondiscrimination Act of 2000.

CBO estimates that enacting H.R. 3709 would have no impact on the federal budget. Because the bill would not affect direct spending or receipts, pay-as-you-go procedures would not apply. The bill's impact on state, local, and tribal governments, and on the private sector are discussed in a separate mandates statement.

H.R. 3709 would extend a moratorium on certain state and local taxation of on-line services and electronic commerce through October 21, 2006. Under current law, the moratorium is set to expire on October 21, 2001. The bill also would expand the moratorium to include certain taxes that were imposed and generally enforced prior to October 1, 1998. Under current law, such taxes are exempt from the moratorium.

The CBO staff contact is Mark Hadley, who can be reached at 226–2860. This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

SUMMARY

H.R. 3709 contains no private-sector mandates, but by extending and expanding the moratorium on certain types of state and local taxes, the bill would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the costs of complying with this mandate would exceed the threshold established in the act ($55 million in 2000, adjusted annually for inflation) at some point over the next five years.

INTERGOVERNMENTAL MANDATES CONTAINED IN THE BILL

H.R. 3709 would extend for five additional years a moratorium on certain state and local taxes that was imposed by the Internet Tax Freedom Act (ITFA). In addition, the bill would remove the grandfather provision of ITFA that allowed some states to continue taxing Internet access. This extension and expansion of the morato-

rium would constitute an intergovernmental mandate as defined in UMRA.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE, LOCAL, AND TRIBAL GOVERNMENTS

Is the Statutory Threshold Exceeded?

Because at least one significant state revenue source—taxes on internet access—would clearly be affected and others might be affected, CBO estimates that the extension and expansion of the moratorium would cause revenue losses that would exceed the annual statutory threshold at some point over the five-year period.

Total Direct Costs of Mandates

UMRA defines the direct costs of an intergovernmental mandate as "the aggregate estimated amounts that all state, local, and tribal governments . . . would be prohibited from raising in revenues in order to comply with the federal intergovernmental mandate." CBO estimates that revenue losses would result from the removal of the grandfather provision for states that, prior to the passage of IFTA, collected taxes on Internet access.

Several states currently levy taxes on Internet access. Based on information provided by these states and industry sources, and using conservative assumptions about actual collections and the projected growth of the market for Internet access, CBO estimates that the repeal of the grandfather provision would result in revenue losses exceeding the threshold at some point over the next five years. It is possible that, in the absence of this legislation, some state and local governments would enact new taxes or decide to apply existing taxes to Internet access or on-line services during the next five years. It is also possible that some governments would repeal existing taxes or preclude their application to these services. Such changes would affect the ultimate cost of the mandate but are difficult to predict. Therefore, for the purposes of estimating the direct costs of the mandate in this bill, CBO considered only the revenues from taxes that are currently in place.

In addition, by extending the current moratorium, the bill may affect the ability of state and local governments to collect certain other taxes. Significant and continuous change within the industry, as well as uncertainty about possible legal interpretations of those definitions, make it impossible for CBO to predict the likelihood or magnitude of such effects on state and local budgets.

ESTIMATE PREPARED BY:

Shelley Finlayson (225–3220)

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the committee finds the authority for this legislation in Article I, section 8, clause 3 of the Constitution.

SECTION-BY-SECTION ANALYSIS AND DISCUSSION

Section 1. Short Title

The act may be cited as the "Internet Nondiscrimination Act of 2000."

Section 2. Extension of Moratorium on State and local taxes on the internet.

Subsection (a) extends for 5 years the current moratorium on taxes on internet access and multiple or discriminatory taxes on electronic commerce found in section 1101 of 47 U.S.C. 151 note, which is scheduled to expire on October 21, 2001. Under the act, the moratorium will remain in effect until October 21, 2006.

Subsection (a)(1)(B) eliminates the current grandfathering of State and local taxes on internet access, which permits taxes generally imposed and actually enforced prior to October 1, 1998 to be collected notwithstanding the moratorium. Consequently, the States which are currently taxing internet access will no longer be permitted to assess such a tax on internet access occurring on or after the date of enactment of the act.

As a technical and conforming change, subsection (a)(2) strikes current section 1101(d) of the Internet Tax Freedom Act, which contains a definition of "generally imposed and actually enforced." Because the exception to the moratorium which was governed by this term will not survive this act, the definition is no longer needed. Subsection (a)(3) merely redesignates subsections to adjust to the elimination of this definition.

Subsection (b) completes the technical and conforming changes required to effect the elimination of the grandfather clause. It strikes from current section 1104(10) language defining "Tax on Internet Access" as a tax on internet access "unless such tax was generally imposed and actually enforced prior to October 1, 1998."

Section 3. Application of Amendments

The amendments to the Internet Tax Freedom Act contained in this legislation shall not apply with respect to conduct occurring before the date of its enactment. Thus, for example, a State which may currently impose a tax on internet access under the authority of the grandfather clause may continue to seek collection of such a tax after the date of enactment, provided the access upon which the tax is assessed was effected prior to enactment.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

PUBLIC LAW 105–277

* * * * * * *

DIVISION C—OTHER MATTERS

* * * * * * *

TITLE XI—MORATORIUM ON CERTAIN TAXES

SEC. 1100. SHORT TITLE.

This title may be cited as the "Internet Tax Freedom Act".

SEC. 1101. MORATORIUM.

(a) MORATORIUM.—No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending [3 years after the date of the enactment of this Act] *on or after October 1, 2006*—

(1) taxes on Internet access[, unless such tax was generally imposed and actually enforced prior to October 1, 1998]; and

(2) multiple or discriminatory taxes on electronic commerce.

* * * * * * *

[(d) DEFINITION OF GENERALLY IMPOSED AND ACTUALLY ENFORCED.—For purposes of this section, a tax has been generally imposed and actually enforced prior to October 1, 1998, if, before that date, the tax was authorized by statute and either—

[(1) a provider of Internet access services had a reasonable opportunity to know by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; or

[(2) a State or political subdivision thereof generally collected such tax on charges for Internet access.]

[(e)] *(d)* EXCEPTION TO MORATORIUM.—

(1) * * *

* * * * * * *

[(f)] *(e)* ADDITIONAL EXCEPTION TO MORATORIUM.—

(1) * * *

* * * * * * *

SEC. 1104. DEFINITIONS.

For the purposes of this title:

(1) * * *

* * * * * * *

(10) TAX ON INTERNET ACCESS.—The term "tax on Internet access" means a tax on Internet access, including the enforcement or application of any new or preexisting tax on the sale or use of Internet services [unless such tax was generally imposed and actually enforced prior to October 1, 1998].

MINORITY VIEWS

We offer these minority views because we are concerned that an extension of the moratorium on taxes through 2006 (as the committee-reported legislation provides) is so lengthy that Congress may never return to the far more important issue of State tax simplification and because the procedural context by which this legislation has been considered has been deeply flawed. Concerns with extending the moratorium through 2006 or even longer have been expressed by representatives of the Administration,[1] and a number of important organizations, including the National Governors Association (in a letter signed by 36, including 22 Republican, Governors),[2] numerous city, county and local governments, organized labor (including the AFL–CIO, NEA, AFT, AFSCME, and the International Union of Police)[3] education groups,[4] the National Retail Federation and a wide variety of individual retailers (such as Wal-Mart, Sears, Home Depot, K-Mart, Radio Shack, Target, and Circuit City),[5] and shopping center owners.[6] (Many of these entities have come together to form the e-Fairness Coalition, representing a total of more than 1.5 million retailers and other businesses.)

Under current law,[7] there is a limited moratorium on State and local Internet access taxes[8] (subject to a grandfather on taxes of this nature imposed prior to 1998)[9] as well as on so-called "multiple and discriminatory taxes" imposed on Internet transactions.[10]

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[1] *See* Advisory Commission on Electronic Commerce, Statement submitted by Commissioners Joseph Guttentag, Andrew Pincus, and Robert Novick.

[2] Letters from Governors to Senator Trent Lott, majority leader and Congressman Dennis Hastert, Speaker of the House (April 7, 2000; April 10, 2000; April 11, 2000; April 12, 2000) regarding urging the rejecting of the Advisory Commission on Electronic Commerce (ACEC).

[3] Letter from the AFL–CIO urging Representatives to vote against H.R. 3709. (AFL–CIO Letter). *See also* Letter from AFSCME, International Association of Fire Fighters, CWA, Dept. of Prof. Employees, AFL–CIO, and SEIU to Congressman John Conyers, Jr. (May 3, 2000) expressing concern regarding the proposed extension of the moratorium on Internet taxes (AFSCME Letter).

[4] Letter from Constantine W. Curris, President, American Association of State College and Universities (AASCU) to John McCain, Chair, Senate Committee on Commerce, Science and Transportation and Congressman Thomas J. Bliley, Jr. (April 7, 2000) urging Congress not to pursue measures such as a permanent Federal ban on e-commerce taxation (AASCU Letter).

[5] Letter from Lisa Cowell, Executive Director of E-fairness Coalition to Governor James Gilmore, Chairmen of the Advisory Commission on Electronic Commerce (March 16, 2000).

[6] Statement of Peter Lowy, Co-President of Westfield America, before the Subcommittee on Telecommunications Trade & Consumer Protection on May 3, 2000.

[7] Internet Tax Freedom Act of 1998, 47 U.S.C. § 151 note § 1101.

[8] Contrary to the understanding of many, the 1998 law did not provide for any sort of general prohibition on Internet taxes by the States.

[9] At the time the Act was passed 12 States asserted that they levied sales taxes on Internet access. Presently, only 10 remaining States have taxes on Internet access charges: Connecticut, Montana, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, and Wisconsin.

[10] A discriminatory tax is one that is imposed on a transaction occurring over the internet but not on no-internet transacation involving similar goods; one, which taxes internet transactions at rates higher than similar no-internet transactions; one which imposes the tax collection obligation for internet transaction on an entity different than one involving a non-intenet transaction; or one which taxes information providers at a higher rate when the information is delivered over the internet. The definition of discriminatory tax also clarifies that certain contact with a taxing jurisdiction will be insufficient to establish "nexus" (the constitutionally required relationship between a taxing authority and the entity on which it seeks to impose a tax collec-

The current moratorium is scheduled to expire on October 21, 2001 and was created as a interim device to allow a commission to study the problem of Internet taxes and the need for developing a "level playing field" for the collection of sales taxes by all forms of retailers. (This unlevel playing field results from the Supreme Court's 1992 decision in *Quill* v. *Heitcamp*,[11] which held that absent congressional authorization, States are not permitted to require sellers to collect sales taxes unless, among other things, the seller has a "substantial physical nexus" within the State.) H.R. 3709, as reported by the committee, would extend the present moratorium for an additional five years—from 2001 until 2006—and eliminate the grandfather of State taxes on Internet access already in place. A summary of our concerns follows.

I. Extending the Moratorium Through 2006 Will Unduly, if Not Indefinitely, Delay Revisiting the More Important Issue of State Tax Simplification

If Congress extends the present moratorium through 2006—more than two presidential elections from today's date—there is a risk that we may never return to the more important issue of State tax simplification. This would undermine a principal purpose of the 1998 Internet Tax legislation which gave the Advisory Commission on Electronic Commerce the ability to consider how best to develop a more simple and rationale system than exists at present.[12]

Unfortunately, the Advisory Commission was unable to reach a consensus on this, or any other important issue. Thus, although we do not support multiple or discriminatory State taxes on the Internet, we are concerned that extending the present moratorium through 2006 would only serve to indefinitely delay work on the real problem—an overly complex system of more than 6,500 local and State sales tax jurisdictions, and the potential of current law under *Quill* to subject similarly situated sellers to different tax collection regimes. Indeed, there is a real risk that if we extend the moratorium until 2006, many interests will be come so dependent on the current system that it will be impossible to ever revisit the issue of State tax simplification. Tellingly, Governor Gilmore, who headed the Advisory Commission on Electronic Commerce, admitted that by the time a five year moratorium expired, consumers would not accept additional taxes, "No tax collector will be welcome on the Internet after 2006."[13]

As the International Council of Shopping Centers explained, "we are deeply concerned that the longer the moratorium is extended, the more difficult it will be for Congress [and the States] to address

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tion obligation). A tax will be discriminatory if: (a) the sole ability to access a site on a remote seller's out-of-state computer server is a factor in determining the remote seller's tax collection obligation; or (b) an internet service provider (ISP) is deemed to be the agent of a remote seller for determining tax collection obligations solely because of the display of a remote seller's information on the ISP's out-of-state computer server.

[11] 504 US 298 (1992). *Quill* held that in order to sustain an interstate sales tax, the tax must apply to an activity with a substantial nexus with the taxing State; be fairly apportioned; not discriminate against interstate commerce; and be fairly related to the services provided by the State. In the events a good is sold across interstate lines without being subject to sales tax, the purchaser remains subject to a comparable "use tax" within their own State.

[12] Internet Tax Freedom Act of 1998, 47 U.S.C. § 151 note § 1102(g)(1).

[13] John Schwartz, *Gilmore Denies E-Tax Reversal; Plan Could Allow Levies on Internet After Five Years*, The Washington Post, Feb. 24, 2000, at E03.

and take action."[14] These same concerns have been echoed by the Vice President of Wal-Mart who warned, "I don't know anyone who believes it will be any easier to resolve the issue in five or six years. In fact, I can almost guarantee you that it will be nearly impossible, because absent a solution, most brick-and-mortar businesses that also sell on the Internet will have been forced to reorganize their corporate structure in order to remain price competitive. . . . Congress should not force businesses to alter their corporate structure simply to remain price competitive."[15]

This is why many of us believe it would be far preferable to extend the present moratorium until 2003. This amendment was offered by Rep. Delahunt, but rejected by the majority on a largely party line vote. It is our hope that by 2003 the States could build on the very serious steps they have already taken to reform and simplify their laws.[16] Then, Congress could consider whether we should approve any interstate process that addresses the simplification issue. If the States were not making any progress by 2003, it would be a simple matter to extend the moratorium for an additional period of time.

II. Failure to Revisit the State Tax Simplification Issue Will Harm Retailers, State and Local Governments, and Individual Consumers

An undue delay, or total failure to revisit the issue of State tax simplification, will harm all interested parties—retailers (both electronic and otherwise), State and local governments, and consumers. The problems with the present system from the perspective of the retail industry are several fold. First, the complexity of the system is daunting. There are presently over 6,500 taxing jurisdictions in the United States, when all State, county and municipal authorities are included. The jurisdictions generally require separate collection, have developed overlapping definitions of goods and services subject to tax, specify differing sets of exemptions and *de minimis* thresholds, have differing bad debt rules, and varying sets of forms and audit systems. Needless to say, any retailer with a physical nexus to a State is subject to a myriad of confusing and complex State and local taxes. This carries with it large paperwork and collection burdens.

Second, the legal uncertainty of the present system can be harmful, even for remote sellers, because of the many questions left unresolved by the *Quill* decision and by current law. Determining the meaning of "substantial physical nexus" for a particular retailer can be highly subjective. For example, would the mere presence of a computer server in a particular State constitute a substantial physical presence for State tax purposes? If an electronic retailer developed its own distribution system, would that subject it to local taxes? Would a retailer's hiring employees or independent contrac-

[14] Statement of the International Council of Shopping Centers on The Taxation of Electronic Commerce to the U.S. Senate Committee on Commerce, Science and Transportation on April 12, 2000.

[15] Testimony of David Bullington, Vice-President of Taxes, Wal-Mart Stores, Inc., before the Senate Commerce Committee, April 12, 2000.

[16] Ongoing simplification efforts by the States are proceeding. Most recently a March 30–31, 2000 meeting in Denver, Colorado focused on implementation of streamlined sales and use tax systems. *See* Statement of Governor Micheal Leavitt before the Senate Commerce Committee on April 12, 2000.

tors to solicit sales or engage in advertising within a State constitute the necessary nexus? How are purely electronic sales of books, movies and sound recordings to be treated? Would the existence of a kiosk to place sales orders through the Internet or a physical return facility in a State constitute the type of physical nexus needed to establish sales tax collection authority? Would it matter whether these physical facilities were owned outright by the remote retailer or through a separate subsidiary? There are no clear answers to these questions under *Quill*—creating a large degree of uncertainty for all electronic sellers, and threatening to artificially constrain their business development plans. The Internet Tax Freedom Act enacted in 1998 also gives rise to legal uncertainty. For example, the meaning of "discriminatory tax" is not fully flushed out, and we are given no guidance on the manner in which the ban on access taxes would apply if Internet access was bundled with other services, such as cable and long distance. All of these issues could be addressed as part of a comprehensive tax simplification effort, yet this will be far less likely to occur if we extend the present system through 2006.

Third, the current disparate tax treatment as between traditional "bricks and mortar" retailers and remote sellers has the potential to cause continuing economic distortion.[17] As the *New York Times* editorial board has written, "[a]n elementary principle of taxation says that taxes should distort purchasing decisions as little as possible. It is not the role of a tax code to determine whether customers shop in stores, online, or by mail order."[18] Similarly, preeminent economist Robert Samuelson has observed, "[e]xempting items sold over the Internet [is] . . . a disguised subsidy that favors one business over another. . . . Ideally, the Internet ought to compete with traditional stores on an equal footing. People should buy online if e-commerce offers lower prices or greater convenience."[19] Yet the present system, by creating a tax incentive to be located in a remote physical location, threatens to do exactly that.[20] This in turn, has the potential to harm local employment and real estate values.

With regard to the impact on State and local governments, an undue maintenance of the current system carries with it the potential for significant financial loss. Sales taxes constitute the most important State and local revenue source, far greater than income and property taxes, with the Census Bureau estimating that 47.9% of State and local revenues come from sales taxes. With projections of online sales estimated to exceed $100–300 billion annually by 2002, State and local governments could lose as much as $20 billion in uncollected sales taxes under the present system.[21] This is why the *Washington Post* warned that loss or significant erosion of

[17] In an industry such as retail sales, where a 1–2% profit margin may be standard, a 6–8% sales tax differential can offer a significant price advantage.

[18] *New York Times*, December 19, 1999.

[19] Robert J. Samuelson, *Fair Play on the Net*, Washington Post Online, March 1, 2000, at A17.

[20] Perversely, the present system also creates an incentive, in terms of State sales taxes, to be located *outside* of the United States as well.

[21] *See* Donald Bruce and William F. Fox, *E-Commerce in Context of Declining State Sales Tax Basis*, Center for Business and Economic Research (CBER), University of Tennessee, Knoxville, February 2000.

sales tax would leave huge holes in State budgets.[22] This, in turn, could have a grave impact on critical services such as police and safety, health, and most notably, education. A consortium of labor unions led by AFSCME, NEA, and AFT has written, "the loss of revenue will significantly impair the ability of States and localities to meet demands for education funding" particularly since "States generally devote 35%–40% of their overall budget to education,"[23] and the American Association of State Colleges and Universities, warned that hasty congressional action in this area "could destabilize State and local revenue systems, which in turn would have an immediate and adverse impact on public services such as higher education."[24]

Finally, the present system could significantly harm individual consumers. This could obviously be the case if individuals faced increasing income and property taxes or declining services as a result of the loss of sales taxes from remote sales. A separate concern is the adverse impact of the present bifurcated system on poor and minorities. According to a recent Commerce Department study, wealthy individuals are 20 times more likely to have Internet access, and Hispanics and African Americans are far less likely to have such access.[25] This means that poor and minorities who only buy locally face a greater sales tax burden than their counterparts. As the AFL–CIO warned, "H.R. 3709 would . . . force poorer working families who do not have access to the Internet to bear a greater share of their State and local sales tax burdens by allowing affluent families with the ability to shop on the Internet to use this medium to avoid their sales tax obligations through October 2006."[26]

III. The Process by which H.R. 3709 Has Been Considered is Deeply Flawed

The process by which H.R. 3709 has been considered has been neither serious nor credible. There have been no Judiciary Committee hearings to obtain input from interested or affected parties. Our markup was scheduled on only one day's notice—the bare minimum required under House and committee rules. Yet we are now in a headlong rush to the House floor, which will likely necessitate several waivers of House rules. For example, the committee report will not have laid over the requisite three days, and we may not have received the required Congressional Budget Office Report, with its analysis of the legislation's impact on State and local revenues.

The entire process appears to have been more the result of partisan political considerations than sound policy. Why else would the majority leader announce that the legislation is slated for floor consideration *before* the committee had heard from a single witness or even scheduled a subcommittee or Full Committee markup? The majority would appear to be using this legislation in a desperate

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[22] *The Internet Tax Game*, The Washington Post, April 6, 2000.
[23] AFSCME Letter; AFL–CIO Letter.
[24] AASCU Letter.
[25] *Falling Through the Net II: New Data on the Digital Divide, National Telecommunications and Information Administration*, National Telecommunications and Information Administration, July 1998 (http://www.ntia.doc.gov/ntiahome/net2/falling.html).
[26] AFL–CIO Letter.

effort to create the appearance of a serious high-technology agenda, even while H.R. 3709 postpones and defers consideration of the larger issues. It is indeed ironic that the majority could claim to be champions of a tax free Internet, at the same time that the Republican Chairman of the Ways & Means Committee is proposing a new 30% Federal tax on sales transactions, including all electronic sales consummated over the Internet.

Conclusion

Interstate taxation is an important and complex issue. It affects the ability of States and localities to provide critical services, such as schools, police, and fire enforcement. It could also impact the growth and viability of e commerce as well as the competitiveness of traditional bricks and mortar retailers. The Judiciary Committee should take its time and get this issue right. At a minimum, we should hear from the affected parties. We are concerned that by extending the present moratorium through 2006, as the majority proposes, we will be delaying or permanently deferring the more important issue of State tax simplification to far into the future, and create a situation where there is little incentive for the States to simplify and reform their own laws. This benefits no one, and we would urge a more deliberative and thoughtful approach.

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