

# INTERNET TAX AND TRADE ISSUES

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**HEARING**  
BEFORE THE  
**COMMITTEE ON FINANCE**  
**UNITED STATES SENATE**  
ONE HUNDRED FIFTH CONGRESS  
SECOND SESSION  
ON  
**S. 442 and H.R. 4105**

—————  
JULY 16, 1998  
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# INTERNET TAX AND TRADE ISSUES

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THURSDAY, JULY 16, 1998

U.S. SENATE,  
COMMITTEE ON FINANCE,  
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, D'Amato, Kerrey, Bryan, Graham, and Moynihan.

## OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order. Today's hearing demonstrates what kind of exciting times we live in. Only a few years ago, the Internet was home to a handful of academics and military personnel, individuals who used the ability to communicate between computer terminals to pass information back and forth in a realm that was quickly becoming known as cyberspace.

And to understand how far and how fast technology has advanced, consider that 20 years ago, there were only 50,000 computers in the world. Today, more than 50,000 are sold in a single day.

Most of these computers come with modems linking tens of millions of men, women, and children around the world together through the Internet. And the worldwide web is growing at the outstanding rate of 2,300 percent a year.

These exciting advances are changing the way we learn, the way we work, the way we communicate with one another. In fact, our Finance Committee has a web page. It has been on the Internet for a year and a half. It receives over 10,000 visitors a month.

The Internet is also changing the way we do business, the way we shop, the establishments we patronize. For example, Amazon.com has virtually revolutionized the way Americans buy books and the way the publishing industry attracts customers.

And Amazon.com is only one of countless businesses that operate over the Internet. Some of the most exciting stock on Wall Street these days relate to Internet browsers, search engines, and service providers.

In the hearing, we are going to take a look at Internet commerce, what all this means, particularly when it comes in the area of taxation of interstate commerce.

The Finance Committee has clear jurisdiction over legislating and setting parameters for State and local taxation. This committee offers the most appropriate forum to examine how State and local taxation of the Internet will affect this powerful medium, its clients, the businesses involved, and the economy as a whole.

This committee is also the place to address trade issues relating to the Internet. In our global marketplace, tariffs and taxes imposed by other countries could have a significant impact on the development of electronic commerce.

There are real and lasting consequences to this important issue. The general approach of the pending legislation is to place a broad moratorium on the ability of State and local governments to impose taxes on the Internet. The moratorium is intended to provide time for our commission to study the issues and to make recommendations regarding taxation and regulation.

There are differences in the pending bills regarding the length of the moratorium, the type of taxes that could be prohibited or permitted, whether to grandfather existing taxes, and the focus, membership, mandates, and ultimate goal of the commission that will eventually make the recommendation.

I look forward to hearing our panelists as they share their insights with us concerning the Internet, its importance and future. This hearing will provide Finance Committee members with an opportunity to learn and ask questions about the Internet and the related legislation.

Before we welcome our first panel, I yield to my distinguished friend and our ranking minority member, Senator Moynihan.

**OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN,  
A U.S. SENATOR FROM NEW YORK**

Senator MOYNIHAN. Thank you, Mr. Chairman. And thank you for pressing the point that this is a tax matter and it is properly before the Finance Committee. It has taken a year to get it here which is hardly the speed at which the Internet moves.

This is a nice example, as I am sure you know, of the collateral rewards of defense research and the Internet after Sputnik and the question of who is going to have the communications advantages in the world in the great age of the cold war.

And the work was done up at the Lincoln Laboratory at MIT under the sponsorship of the ARPA, the Advanced Research Planning Agency. Jack Lowina, a particular friend, was one of the ones who did it.

And as recently as 1971, there were I think 23 computers involved in the whole mode. And today, there are 28,000. It is just astonishing. It is galactic speed. And it is about time we address the subject, as we are going to do. And I look forward to it. And thank you.

The CHAIRMAN. Thank you, Senator Moynihan.

We have a very full morning. So I am going to move directly to the Senators who have asked to appear before the panel. So I would appreciate, and I welcome Senator Bumpers, Senator Lieberman, Senator Wyden, Congressman Cox, if you would all come forward, please.

Gentlemen, as I mentioned, we have an extremely full morning of panels. So as you have been advised, we are going to limit your discussions to 5 minutes. Your full statements, of course, will be included as if read.

With that, it is a great pleasure to welcome you here, Senator Bumpers.

**STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM ARKANSAS**

Senator BUMPERS. Thank you very much, Mr. Chairman. And I will submit my prepared remarks for the record.

Mr. Chairman, this deals with what has been around ever since I brought it around about 5 years ago. And that is allowing the States to collect taxes or to require mail order catalog sales to be taxed.

Most people think that is a new tax which it certainly is not. And I will come back to that in just a moment, but first the history. Until 1967, this issue had been pretty much in limbo, but as the National Bellis Hess case in 1967 said that the States may not collect sales taxes from mail order catalog sales because, number one, it violated the due process clause of the constitution and number two, it was a violation of the interstate commerce clause of the constitution.

In 1992, North Dakota in a case called Quill versus North Dakota, the Supreme Court reversed itself on part of that. The Supreme Court said that we now find that taxing of mail order sales would not violate the due process clause. It would still violate the interstate commerce clause, but Congress has the authority even to rectify that.

So we find ourselves now in this position. The States, 45 of whom have use taxes in effect right now. And I will come back to that in just a moment. But this tax is not a tax at all. They already have a use tax.

If you order something from Land's End right now, you are obligated as the consumer to pay that tax in Delaware because you have a use tax in Delaware, the same thing in New York and Nebraska. The problem is you do not know that. I dare say nobody in this room or very few people in this room realize that the tax is in existence now. It is just not collected and it is not collectible.

The only way these taxes can be collected is if there is a presence in the State. This example, for example, Eddie Bauer. Eddie Bauer is a big mail order house. I used to order from them when I was a young lawyer. But they also have a physical presence in Maryland and Virginia and the District. They have stores here.

Now, the courts have always ruled that if they have a presence in the State, that does not violate the interstate commerce clause. And the State in which they have a presence can require them to collect mail order taxes on mail order sales.

Now, one of the common complaints you will hear—and I want to get this in. It is a little out of order, but I want to get this point in. One of the things I first faced when I tackled this issue was the complexity of it. You think of all the jurisdictions who have different use tax amounts, rates.

Bob Bennett, a very respected member of this body, was one of the founders of Franklin Quest which is one of the biggest mail order office equipment concerns in the country.

He told me that in the age when they started that business, and he is a supporter of this provision, the question came up, are we going to collect sales taxes on the sales to all the States? They thought it over and they studied the complexity of it and found it was not complex at all.

And Bob Bennett will be the first one to tell you. Now, they have some stores now, too. So they are required to collect taxes where they have a physical presence in the State. But Bob Bennett will be the first one to tell you that it is not complex at all, that all they do at the end of the month is push a few computer buttons. The checks roll right out to the States.

In my bill, we give the States the authority to enter into agreements to pass a law, for example, saying we will collect a \$.05 sales tax in my State, for example. We will collect this \$.05 sales tax or something less than that. They have a right to reduce it for mail order sales. And they in turn will distribute them to municipalities and counties that have use taxes in effect.

And as I say, Bob Bennett will be the first one to tell you that there is no problem at all.

Now, Mr. Chairman, we talk about unfunded mandates. Incidentally, CBO has something to say about that on Senator Wyden's bill. I do not want to get deeply immersed in his bill. I am not an expert on it. I will make a couple of comments on it in just a second.

But when it comes to unfunded mandates, these mail order houses, their sales are increasing dramatically. It is estimated that in 1998 their sales will probably exceed \$100 billion. The estimates are that this costs the States, the municipalities of this country \$3.3 billion a year. That is an unfunded mandate because Congress simply does not give them the wherewithal to collect it.

There are a lot of problems with the system as it exists right now, but, number one, it is a taxpayer's surprise. It is not uncommon. And some States, on their income tax return, will have a question: do you buy anything by mail order sale this year? Yes. How much? \$100. Five percent of that is \$5. Please remit.

Now, Maine does that. And there are a few other States that do that, but their tax collections are just minimal. But one thing, as I say one of the problems with the law as it exists right now is this ugly surprise.

I was just getting warmed up. [Laughter.]

Well, let me hurriedly make a couple of points, Mr. Chairman, if I may.

The CHAIRMAN. We are going to have to keep to the 5 minutes, but very briefly.

Senator BUMPERS. I understand. I just want to say that North Carolina, for example, has a lot of furniture sales. Just to dramatize the thing, one couple from Florida got an ad saying: no sales taxes. Come up here, furnish your house.

They go up and buy \$40,000 worth of furniture for their new house. They cross the line back into Florida. And they get stopped. And where did all this furniture come from? It came from North



Carolina. So they give them a little receipt saying, please remit. And they wound up having to pay a substantial amount of sales tax on that.

The second problem with it, of course, is as a former main street merchant as well as a country lawyer, it is terribly discriminatory against main street lawyers who have to pay these taxes.

And I might say this is a random thought. It does not cost you an extra penny. If you exempt these taxes on the Internet sales which are going to run to \$300 billion and you are forcing Barnes and Noble to compete with people like Amazon Books, you are going to see an erosion of the tax base in this country that municipalities and cities simply cannot except.

So as a main street merchant, I would resent having to compete with people who do not have to pay that 5 to 10 percent sales tax. And as I said earlier, \$3.3 billion is what they are losing.

And do not let them tell you, they do not require any police services. They do not require this service. Why should they be taxed?

You would be interested in knowing that are 11 million tons of their catalogs. You talk to mayors and county judges or county executives in the country, they will tell you that one of the biggest problems they have are these catalogs and the landfills. So they are causing plenty of problems. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

[The prepared statement of Senator Bumpers appears in the appendix.]

The CHAIRMAN. Now, Senator Wyden.

#### STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you very much, Mr. Chairman. Congressman Cox and I introduced the Internet tax freedom bill in March of 1997. And we very much appreciate the chance to come and be before you.

The legislation is about one principle. And that is we believe that the Internet ought to be treated in a fashion that is technologically neutral. That means if you go somewhere and pay a 5-percent State tax if you walk into a store and you purchase something, if you purchase those same goods over the Internet, you ought to pay exactly the same thing.

That is not being done today. And the east coast is a very good example and I think illustrates what our legislation is all about. If you purchase the Wall Street Journal in the State of Connecticut through traditional mail, it is just sent in the mail and you pay for it that way, you do not pay a tax on that subscription.

But if you decide to renew your Wall Street Journal, a subscription online, Connecticut taxes that subscription as a date of processing service. So that is technologically discriminatory.

In the old world, you did not pay a tax. In the new world, you would. That is the kind of the thing that the Cox-Wyden legislation simply does not allow. And that is the heart of what we are trying to do in our legislation.

Point number two is it is very clear that in the modern world, Senator Kerrey I know does a lot of shopping online. If you in effect live in, say, Rapid City, South Dakota. You are running a small

business. You want to send a token of appreciation to a customer in Ames, Iowa.

You log onto the Internet in another State, say, Virginia using an Internet service provider. Then you end up sending a gift basket from Harry and David's in Medford, Oregon, one of our fruit companies. You can end up paying taxes in scores of jurisdictions under current law.

We think we ought to take a time-out and try to sort through that because if we have a crazy quilt of technologically discriminatory taxes, it is our view that the Internet really could become a pocked marked empty, 21st century toll road. And that is something that nobody in the Senate or the Congress wants to see.

And finally, because of all the confusion out across the country with respect to these taxes, we are sending a pattern of small businesses in particular getting clobbered by retroactive Internet taxes.

The Senate Commerce Committee, when hearings were held there, heard from a small businessman from Nashville, Tennessee. The Internet service provider told initially that what he was doing was not a taxable service. The revenue department in that State reaffirmed it.

And then, two later years, 1994 and 1996, Internet use grew. There is political pressure. They decided to impose the tax retroactively. And the person is out of business.

So I would cite those three examples as why the legislation is needed. One, we want to make sure that we have a technologically neutral policy. Second, we want to sort out how many jurisdictions ought to tax and what kind of definitions we ought to have, number one. And third, we have this problem of retroactive taxes.

Now, with respect to Senator Bumpers points, two points are clear. First, main street business in this country has overwhelmingly endorsed the Cox-Wyden legislation. And we will make it part of the record, the endorsements we have received.

The reason that they have is that they badly need fair treatment in terms of taxes to compete with the big guys. To compete with the Wal-Marts and the big guys, they cannot afford to hire scores of accountants to go out and sort through these transactions.

They need something. They need a tax system which, for example, makes geography irrelevant so that they can compete in the global economy with everybody else. And that is why they have endorsed the legislation.

Finally, with respect to CBO, despite the opponents of this legislation, the best efforts on two occasions, CBO has passed on the effort to say that this was an unfunded mandate. And I would like to make those a part of the record as well.

[The information submitted by Senator Wyden appears in the appendix.]

Senator WYDEN. Finally, it seems to me that the need to come up with some common terms here is just critical. An Internet service provider can be treated as a data processor in one State, as someone providing a telecommunication service in another, Internet access, a third.

We need to come up with some sensible, understandable terms here that can be used by the States so that there will be fair treatment.

What it really comes down to, Mr. Chairman, is that we cannot afford to have a significant number of 30,000 taxing jurisdictions in our country, and that is the number that we have, going out and pursuing on their own without any regard to the consideration of small business, the need for some common language here, their own kinds of taxes.

We have in our legislation done everything we could to preserve all existing State revenue systems. And that is outlined in the legislation. All the bill does, it says that if you are singling out the Internet for selective and discriminatory treatment, that will not be allowed during the time in which this legislation is on the books.

So we thank you for the chance to come. We are especially interested in working with you on the provisions relating to international consideration of Internet transactions.

The bill does direct the President to seek bilateral and multilateral agreements through the appropriate trade organizations, including the WTO and other appropriate organizations.

And I would ask that my full comments be made a part of the record.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Thank you, Senator Wyden.

It is a pleasure to welcome you here, Congressman Cox.

**STATEMENT OF HON. CHRISTOPHER COX, A U.S.  
REPRESENTATIVE FROM CALIFORNIA**

Congressman COX. I thank you very much. I am pleased to join with such distinguished colleagues in discussing this issue. It is worth asking how it is that legislation like this could have enjoyed the success thus far that it has.

It was reported in the House by the Judiciary Committee, endorsed by Chairman Henry Hyde and ranking member John Conyers, and voted out unanimously. It came out of the Commerce Committee, endorsed by John Dingell and by Tom Blylea and voted upon unanimously in favor.

When we brought it to the floor of the House, we did so, first, we thought we would have to have it ruled. But it was so obvious that everybody had kicked the tires on this sufficiently thoroughly that we could bring it up on suspension which requires two-thirds. And even at that, we did not even have a recorded vote because everybody out on both sides said nobody was going to vote against it.

The President has endorsed the legislation. I went out to California and made a significant talk announcing his endorsement even before we had reached all of our several accommodations with the State and local groups who have, as Senator Bumpers, a strong interest in this.

I negotiated with the NGA directly and indirectly with the rest of the Big 7 for a period of 7 months. And I think everybody gets something out of this bill as a result. In specific on the question that Senator Bumpers raises, we have for the first time a legislative vehicle to address those concerns which require changes in Federal law.

The Quill decision after all which is the status quo says that you cannot tax remote sales. It does not matter if they are on the Internet, mail order catalogs, what have you.

The State where the consumer lives cannot tax those sales. This is the dormant commerce clause where we could pass a law and reverse that decision, but Congress has not done so. So if we do nothing, if we do not pass this bill, if we just sit back and watch, then there will be no taxes on remote sales period.

But now, in this legislation, we are establishing a means for not only the National Governors' Association, but also the National Conference of State Legislators, the National Association of Counties, the United States Conference of Mayors, the National League of Cities, the International City-County Managers Association, and the Council on State Governments to all get together and recommend to Congress how they would like to change that.

And frankly, given the newness of the Internet, given the uncertainties that we all have about what this is going to become in two or three or four or 5 years, that kind of advice and the 3-year time out that we have on the House side of the 6-year time out that you are considering over here makes a lot of sense because we will know a lot more at other end of that time period than presently we do.

In my view, a disproportionate amount of attention, however, has been focused on the State and local tax aspects of the Internet. The bill is not about that.

The bill, as my colleague Senator Wyden outlined, instead says we cannot have discriminatory or multiple taxes against the Internet and expressly we will not have two other kinds of taxes, a bit tax which Europe considered, and even Europe is now rejecting, and Internet access taxes.

And those two kinds of taxes when the NGA, all the Governors came to Washington and met on this, they recommended Congress prohibit for all time, not just for 3 years or 6 years, but forever.

The only other part of this bill that should concern us is that we are directing the administration to go out and preach to the world that the Internet should be a global, tariff-free zone.

Unless we get rid of discriminatory taxes in America, unless we have a sensible regime here that has uniformed, nondiscriminatory standards, our negotiators will be crippled in their efforts abroad to convince our trading partners that we should not be discriminated against, Americans should not be discriminated against in international commerce.

Right now, United States businesses excel in information and media services. Collectively, information and media services where we lead the world add \$20 billion to our balance of trade with foreign nations. The continued commercial development of the Internet is expected to provide even greater opportunity for United States firms as the Internet explodes, as everyone predicts it will, over the next several years.

And that is why not only President Clinton, but the Treasury Department has come up here and testified and supported this bill, why our United States Trade Representative supports this bill, and why, as you have heard, taxpayers, individuals and businesses alike support this bill.

I want to make one final point. This is a Revenue Committee. In the House of Representatives, as I outlined, we considered and reported this bill from the Commerce Committee and the Judiciary Committee. We did not consider it in Ways and Means. And therefore, there is no prohibition on Federal discriminatory or multiple taxes.

I would recommend that the sensible addition to this bill by this committee would be to state expressly that Federal component that is likewise our Federal policy that we will not have these taxes on the Internet.

We do have them presently, that we ought to state it explicitly as a matter of policy and we can take a further substantive step and legislate that the existing 3 percent Federal excise tax on telecommunications shall not apply to the Internet. That is our current Executive Branch interpretation. And in any case, we should clarify that.

There would be no revenue impact because that is the present interpretation of that law. The addition of a Federal component of the moratorium would be very, very welcomed. And because that is the jurisdiction of your committee, I think you could improve the bill in this respect markedly.

The Governors, by the way, would strongly support that as well. The NGA would strongly support that. And I thank you for taking this bill up.

The CHAIRMAN. Thank you, Congressman Cox.

Now, we are pleased to hear from Senator Lieberman.

**STATEMENT OF HON. JOSEPH LIEBERMAN, A U.S. SENATOR  
FROM CONNECTICUT**

Senator LIEBERMAN. Thanks, Mr. Chairman. I like this system you have here. You and I share an interest in a particular sport. When I heard the bell, I was ready to come out of my neutral corner and begin boxing.

Senator MOYNIHAN. You have already been turned off. [Laughter.]

Senator BUMPERS. I like it when Senator Lieberman is talking. I do not like it when I am talking.

Senator LIEBERMAN. That is quite appropriate. Thank you, Mr. Chairman. Thanks, Senator Moynihan and members of the committee. I appreciate very much the opportunity to be here with my colleagues today.

Last March, Senator Gregg introduced S. 1888, the Internet Fairness and Interstate Responsibility Act, which we reached to give the acronym NETFAIR. We saw this all along as a bill complementary to S. 442. And in fact there has been, as has been indicated I believe by my colleagues, a coming together here kind of, if you will, marriage in cyberspace, if not in heaven of these respective proposals. And I feel very good about them.

The tax moratorium proposed provides a time-out from State and local taxes for a 3-fold purpose, to allow this nascent industry time to grow, to ensure that Internet transactions are not discriminated against compared to other similar commercial transactions and finally to bring all the relevant parties to the table and force a discussion of the issues where a specific deadline in mind.

Mr. Chairman, the concern here is that we have an industry in its infancy. And we ought to let it grow before the tax man jumps on its back. We ought to let it grow before it has to contend with the kind of unpredictability of State and local taxation that is out there now.

Obviously, every company, everybody in business faces a sometimes confusing web of taxation, but most companies are ultimately able to determine what their tax liability is before they begin to sell in a State.

A hardware store, for instance, knows that it will be classified and treated and taxed as a hardware store. But an Internet company has no way of knowing in the current circumstances as it begins to think about investing and expanding its reach how it will be treated.

In New Mexico, for example, Internet access charges are subject to New Mexico's gross receipts tax. In Ohio, the Internet is taxed as an electronic information service. In Tennessee, it is a telecommunications service. And in Connecticut, it is a computer and data processing service.

Often because this business, the Internet is moving so rapidly, the determination of a company's status is made retroactively. So an important function of the commission established by the merged bills is to create uniformed categories for these new Internet companies. It gives these firms some certainty as to how they will be treated in the different States.

In our legislation, we suggest the Commission develop model State legislation, not to preempt States, but to help them and create some uniformity for people who are in this business.

Not all States, I hasten to add, are running to tax the Internet. Some in fact are moving in the opposite direction. Before the House bill passed, two States, Texas and South Carolina, asked not to be exempted from the tax moratorium because the Governors are taking a stand against taxation of the Internet.

I am happy to announce this morning that my own Governor, John Roland, of Connecticut has asked that Connecticut not be exempted either because he intends not to have the State tax Internet sales. And that is happening all across this country.

Mr. Chairman and members, the focus of the debate has up to now been mainly domestic. But as Congressman indicated, I think we need to consider the consequences of our actions on the competitiveness of American companies in a global market and the ability of our companies to reach across national boundaries to achieve sales via the Internet.

We also have to think about the reaction of our trading partners because the administration has been negotiating internationally for agreements to put no tariffs on Internet trade. In some sense, it is not surprising because the United States is now the leading seller of goods and services over the Internet. We have an advantage here, a head start.

According to Forrester Research, online transactions totaled \$9 billion in 1997. Business to business transactions made up the majority of those online transactions with two American companies accounting for almost half, Cisco Systems with \$3.2 billion in online sales and Dell Computer with \$1 billion.

Sales of entertainment and travel tickets online estimates are will come to over \$10 billion by 2001. And online stock trading is predicted to account for 60 percent of the discount brokerage industry within four years. This is moving very rapidly.

One final point which is the remarkable breakthrough access that the Internet gives to give small companies, in a sense putting them on an equal footing with the larger companies.

I cite as an example Coastal Tool and Supply, a small, older, family-run tool company located in Hartford, Connecticut. It has weathered the recession that we had in the late 1980's and early 1990's, battled against the big guys on the block, the Home Depots of the world.

But suddenly, Coastal Tool and Supply has the opportunity to go on the Internet, in a sense to jump over the big guys down the block. And its sales have grown an astronomical 474 percent between 1996 and 1997 with estimated earnings for 1998 exceeding \$1.5 million. This is an Internet success story that will be repeated.

We are experiencing a wonderful period of growth generally in our country. I think Internet sales give us the opportunity to continue that growth. And I think part of it is to lay off for awhile, give these companies a tax moratorium. And when we come in if we do with taxation that it be well thought out and that it be fairly and equally applied. I thank the Chair and ranking member and members.

The CHAIRMAN. Thank you, Senator Lieberman.

And I appreciate all four of you being here. We are not going to have a question and answer period because we do have several panels.

Thank you again.

Senator MOYNIHAN. Thank you very much.

The CHAIRMAN. It has been pointed out that the administration has been following the development of the Internet, and has been representing the United States in various international conferences both on tax and trade issues. I am eager to hear the administration's perspective on the legislation.

Senator KERREY. Mr. Chairman, if I could a minute. I appreciate your wanting to move this and I know you have other panelists coming up.

The CHAIRMAN. The problem, Senator Kerrey, is that the last panel ends up during lunch and really does not give them a fair opportunity to present their case.

Senator KERREY. I appreciate it. Let me just say then in 60 seconds or less that I am very much interested in this legislation. But if you look at the development of Internet companies and if you look at what the States are doing actually backing off of taxing Internet companies, you look at what the market is valuing Internet companies, you have Internet companies out there no net income being bid up \$6 or \$7 billion.

I mean, to use the word "infant" on this industry as if it is in a perilous state of affairs seems to me does not either compare to what is going on in the marketplace or what the States are doing. And I just hope that we can get some balance here as we discuss this very, very important issue.

I am inclined to look at some sort of a moratorium as is being suggested, but if you look at what is going on out there, Internet companies are not struggling to come up with capital. There is a lot of other small businesses out there that are struggling to come up with capital. Furthermore, States are backing off.

So I do not know. And I want to make sure that we do not come in here intending to address a problem the main fact would be either small or different than what was just represented by this panel.

The CHAIRMAN. Very good. Thank you, Senator Kerrey.

As I was mentioning, we are eager to hear the administration's perspective on the legislation, as well as learning some details of the international discussions relating to the increased global use of the Internet.

So we will begin with the Treasury perspective. Mr. Guttentag will be here to represent the administration. And then, we will turn to the trade side of the equation with Mr. McPhee.

Mr. Guttentag, would you please proceed?

**STATEMENT OF HON. JOSEPH GUTTENTAG, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL TAX AFFAIRS, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC**

Mr. GUTTENTAG. Thank you, Mr. Chairman. I am pleased to be here this morning to present Treasury's views on State and local taxation of the Internet and more broadly its views on taxes and the Internet, especially in the international context.

When I advised Deputy Secretary Summers of this important hearing, he prepared a letter to reflect his continued strong support for the Internet legislation presently being considered by the Congress. I have delivered the letter to you, Mr. Chairman, to Mr. Ranking Member. And I hope that it can be included in the record of this hearing.

The CHAIRMAN. Without objection.

[The letter provided by Mr. Guttentag appears in the appendix.]

Mr. GUTTENTAG. I have also submitted prepared testimony which I request be made a part of the record and would like to briefly summarize Treasury views.

Treasury has continually supported Internet legislation which would impose an appropriate moratorium on State and local taxes and also establish a commission to deal with the means of creating a State and local tax regime which will permit nondiscriminatory taxation of electronic commerce and not permit the Internet to become a tax haven.

Since Secretary Summers testified in favor of these principles last year, the Congress has made substantial progress with the help of both the State and local tax authorities and the affected industries of the goal to arrive at an appropriate solution to this admittedly difficult problem.

The forum of the legislation which I understand has had the most input from the various interested constituencies is the Internet Tax Freedom Act as passed by the House and was addressed by Messrs. Cox and Wyden just before my talk.

There would be a 3-year moratorium on sub-national taxation of the Internet, including taxes on Internet access and bit taxes. Mul-



tiple and discriminatory taxes on electronic commerce would be prohibited. The moratorium would not apply to Internet access taxes imposed by certain States if certain conditions are met.

The bill establishes an Advisory Commission on Electronic Commerce that will address issues concerning the taxation of all remote sales. The commission consisting of the Secretaries of the Treasury and Commerce and the Attorney General or their representatives, business, taxpayer, and sub-national government representations in consultation with the National Tax Association would undertake a broad and thorough study of numerous issues concerning domestic and international taxation of the Internet and electronic commerce.

We can support this proposal, Mr. Chairman, and would look forward to working with the members to resolve the open issues.

Now, the legislation to which I have just referred does not, of course, involve Federal-level taxation. However, the broad tax and trade implications of the Internet and related new technologies make it imperative that we help ensure an appropriate legislative background that will encourage the expansion of this wonderful new technology.

We have worked closely with the many important constituencies vitally interested in this legislation, several of whom are represented today. And we look forward to continuing to do so.

The proposed legislation would also direct the President to seek agreements to eliminate Internet tariffs and discriminatory taxation. We have already undertaken several efforts in this regard to which I will refer briefly.

Almost 2 years ago, Treasury published Selected Tax Policy Implications of Electronic Commerce. And this has fostered similar documents by several other countries and encourage the development of a study of this issue and desirable tax principles.

We have been working actively with the Organization for Economic Cooperation and Development which has assumed the lead of facilitating the necessary international agreements.

In October of this year, the OECD and Canada will host a ministerial conference which will discuss basic framework conditions essential to the establishment of international tax rules consistent with our policy and which will help provide the level tax playing field essential for the development of this industry.

The ministerial conference will provide an opportunity for representatives of the various Internet and electronic commerce industries to engage and work with tax officials from some three dozen different significant countries to begin to resolve the tax issues involved.

The basic principles that we seek to achieve internationally are quite similar to those just described which are reflected in the pending legislation that deal with State and local taxation. Treasury opposes new taxes specifically and discriminatingly imposed on the Internet.

For example, as Mr. Cox mentioned, some jurisdictions have considered the imposition of a bit tax, that is a tax based on the amount of information transmitted on the Internet. We have been successful in obtaining international recognition of the undesir-

ability of such tax. The European commission has strongly rejected that tax.

We will continue to work internationally to develop a sound and consistent taxation system which provides for neutrality, transparency, ease of administration, and, of course, nondiscrimination.

Mr. Chairman, Treasury looks forward to working with you and your colleagues toward the development of a tax system at the Federal and sub-Federal level and the creation of necessary international agreements which will enhance the development of the Internet, electronic commerce, and other related technologies, and which will at the same time assure the necessary tax revenues at all levels of government. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Guttentag.

[The prepared statement of Mr. Guttentag appears in the appendix.]

The CHAIRMAN. And we will now hear from Mr. McPhee.

**STATEMENT OF JOHN E. MCPHEE, DIRECTOR, OFFICE OF COMPUTERS AND BUSINESS EQUIPMENT, TRADE DEVELOPMENT, INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE, WASHINGTON, DC**

Mr. MCPHEE. Thank you. Mr. Chairman and members of the committee, I want to thank you for inviting the Commerce Department to speak to you today about the important issue of taxation of electronic commerce. I would like to address the international trade aspects of these bills within the global context of electronic commerce. And I would defer to the Treasury Department on any issues of tax policy.

We have a number of estimates on the growth of the Internet and the use of online commerce. And I will not belabor that point. It is growing very rapidly and it would appear to be large amounts of dollars in the near term.

We agree with the declaration in the two bills that the Internet should be free of foreign tariffs, trade barriers, and other restrictions. The administration has already begun work, as Mr. Guttentag said, in a number of international fora, the WTO, OECD, APEC, and the Free Trade Area of the Americas. I will briefly review what our initiatives have been in these fora.

Most significantly, we think having convinced our fellow members in the WTO to agree to a standstill on the imposition of customs duties, we feel that it is an important achievement. 132 member countries made the commitment to not impose these duties on electronic commerce.

In addition to that, in the declaration for the Ministerial Conference in May of this year, there was a call for a comprehensive work program on the trade-related aspects of electronic commerce. This work program will encompass issues relating to trade in goods and services, government procurement, intellectual property, and trade and economic development. The work program will specifically look at how electronic commerce fits into the existing WTO framework.

Similarly, on the OECD, they will examine the role of electronic commerce in strengthening the multilateral trade system. You have already heard mention by Mr. Guttentag of the taxation area. We

have a staff involved right now as we speak in fact in Paris working on the agenda on a broader set of issues that will be addressed in the Ottawa ministerial in October.

In the APEC, we have been very active. There is an Ad-Hoc Task Force on Electronic Commerce which is undertaking both substantive work and coordinating with other APEC working groups in a number of important policy areas, including identifying impediments to electronic commerce in the region and facilitating the use of electronic commerce in APEC.

Finally, in the context of the Free Trade Area of the Americas, a joint government-private sector Committee of Experts on Electronic Commerce has been established. The committee will make recommendations to the trade ministers on how to increase and broaden the benefits to be derived from the electronic marketplace in the western hemisphere and how electronic commerce should relate to the negotiations of the FTAA.

Section 5 of H.R. 4105 would require the Secretary of Commerce to prepare a report on foreign barriers to U.S. trade in electronic commerce and telecommunications services on their impact and on measures to foster electronic commerce in the U.S. and in foreign markets.

In our traditional role at the Commerce Department of promoting domestic and foreign commerce, we have taken up the responsibility of ensuring and enhancing U.S. competitiveness in the electronic commerce arena.

Before commenting on this requirement, however, we would need to discuss the matter further with the Office of the Trade Representative and others within the administration to ensure that we do not duplicate existing authorities and ongoing activities.

In conclusion, the administration wants the Internet to provide an open and stable environment for trade and commerce with a minimum of government regulation. Commerce conducted over the Internet should remain free of tariffs and customs duties. And we would oppose any tax that would apply to electronic commerce in a discriminatory manner.

With that in mind, we support the proposals for a tax moratorium and the provisions relating to international trade in electronic commerce in Senate 442 and the House of Representatives 4105. And we look forward, Mr. Chairman, to working with the committee on passage of the legislation in this regard. Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. McPhee appears in the appendix.]

The CHAIRMAN. Would any of the tax treaties between the United States and other countries need to be revised given recent developments with regard to electronic commerce issues?

Mr. Guttentag.

Mr. GUTTENTAG. Mr. Chairman, our approach to these issues and the one that we are working on with our colleagues overseas is that the basic principles in our tax treaties are perfectly suitable for dealing with these new technologies.

We may very well need additional interpretations of the treaties in dealing with specific cases, but we really believe that the basic

principles which govern our tax treaties will serve us well in the future with these new technologies.

The CHAIRMAN. May I ask you this, Mr. Guttentag? Various legislative proposals with respect to the Internet, as you know, include the formation of a commission to study Internet tax issues. What international tax issues do you think should be considered by any such commission?

Mr. GUTTENTAG. The international tax issues certainly, first of all, as we mentioned, tariffs which are outside the tax area. They are already being considered and dealt with in the WTO.

The questions dealt with internationally relate to whether a company is deemed to be present in another jurisdiction because it has a web site on a server in that area. And those are the kinds of technical issues that may need further exploration.

Though as I said before, I think that our present agreements are well suited to deal with these issues. And we are always looking to expand our web of tax treaties to cover more countries.

The CHAIRMAN. Let me ask you this, does the administration have any concern about the Federal imposition of a moratorium on State taxation? And what are your thoughts about how long a reasonable time period for a moratorium should be?

Mr. GUTTENTAG. Well, we believe that the moratorium which in the various pieces of legislation which range from indefinite down required reconsideration. And we are satisfied that the 3-year moratorium which is contained in H.R. 4105 is an appropriate period of time.

But again we believe that that period is one that should be addressed by the affected parties which are the State and local governments and the companies involved.

The CHAIRMAN. Mr. McPhee, as you explained in your testimony, the administration is already moving ahead on several fronts with its own initiative on electronic commerce that is designed to prevent the imposition of tariffs, discriminatory taxes or other barriers to trade via the Internet.

Would the negotiating objective set out in the legislation before the Senate be sufficient to cover the full range of actions the administration has under consideration in WTO, OECD, APEC, and the FTAA negotiations?

Mr. MCPHEE. Well, Mr. Chairman, we looked quickly after we received this question and made some comparisons. I think our first review, we would feel that the House version of this bill has a broader agenda set of issues than does the Senate version.

And as you probably know, we have, following the President's paper that was released July 1, 1997, been hard at work on as many as 13 issue areas: privacy, content, standards, and intellectual property rights, etcetera.

So our agenda in most of these international fora is quite broad. And I would say that therefore the House bill would probably be most coincident with that broad agenda.

The CHAIRMAN. Let me ask you this, achieving standstill on the imposition of tariffs on Internet services under the WTO was a significant achievement. But what is the likelihood that we will simply see our trading partners erect other forms of trade barriers,

such as discriminatory technical standards as they have done in a number of other areas as tariffs fell?

Mr. MCPHEE. We anticipated that that sort of scenario could result. And the President has tasked the Commerce Department and USTR to look carefully at technical standards development and ensure that they are not used as new forms of trade barriers.

It is my personal belief and after talking to a number of people in various countries that the benefits of electronic commerce, the Internet and online environment are becoming clearer all the time. And I think that one of our major tasks will be with our trading partners to ensure that they understand the links between that and economic growth.

Then, we are confident that when that becomes clear that we will have less trouble with erecting technical standards or any other kind of barriers that would in fact blunt the benefits that these countries will be attaining from the online environment.

We certainly have a history of long-term trade negotiations over tariffs and non-tariff barriers. And you will probably see more of that within the online environment. But I think that a lot of people are becoming aware quickly that this is a very beneficial technology.

The CHAIRMAN. Let me ask you this, there is a distinct difference between the current regulation of Internet services which remain relatively free of regulation and import barriers and the regulation of goods sold internationally via the Internet which are subject to many barriers. I am wondering if it is worth asking the commission proposed under the legislation to examine that distinction and its implications for the future development of electronic commerce.

Mr. MCPHEE. Well, as you know, we are working diligently in international fora to remove trade barriers on not only the Internet, but also on goods and services that are traded normally and in all these fora.

And in addition, in many of these fora, such as OECD Trade Committee and the WTO, they have begun to take up consideration of these differences and begin to examine whether there should be, for example, in the case of the WTO, where the electronic transmissions are only goods or services or constitute a new product which could be labeled digitalized information.

In the OECD Trade Committee, they are considering looking at products supplied over the Internet that are distinct from either goods or services as normally traded.

So in the international fora in which we are active, many of these issues are being addressed. And I guess our initial reaction would be that we do not think the commission would need to look at this.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Yes, Mr. Chairman. I am beginning to get a sense of the international dimensions here. I appreciate very much Mr. McPhee's comments and Secretary Guttentag's.

I have one question of just definition which perhaps we can get resolved here. We have a Federal tax on telephones when you speak on the phone. And yet, we have no tax on communications on the Internet which for the most uses telephone lines. Is that not the case, sir?

Mr. GUTTENTAG. Yes, it is.

Senator MOYNIHAN. Yes. Is there a disparity here? Should we tax both or tax neither? And does the FCC define which and why? Just help this Senator.

Mr. GUTTENTAG. Well, that is certainly an issue which needs to be looked at it and is one which obviously, as you note, involves the FCC. And I am hesitant to impede on their jurisdiction over—

Senator MOYNIHAN. Oh, it happens all the time in this committee. [Laughter.]

Mr. GUTTENTAG. So certainly, all of these issues do—that certainly does require that we examine this closely, making sure that we do not result in double taxation, that we may need a completely new set, a new type of regime over the use of what we now call telephone lines as in the future those lines may involve many types of communications other than telephones, as you note. But I would like to leave that to my colleagues at the FCC and not attempt to impede their jurisdiction on this subject.

Senator MOYNIHAN. Well, sir, with great respect, you are with the Treasury Department and taxation is your responsibility. Could you think it over and perhaps give us a memo, just a note on what you think?

Mr. GUTTENTAG. Certainly.

Senator MOYNIHAN. And tell us how we might proceed?

Mr. GUTTENTAG. Certainly, Senator.

Senator MOYNIHAN. I think this is a question, Mr. Chairman.

The CHAIRMAN. Very appropriate.

Senator MOYNIHAN. Well, thank you both very much. It was very, very clear testimony.

Mr. MCPHEE. Thank you.

The CHAIRMAN. Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman. Senator Moynihan raises I think a legitimate public policy question. Is there a public policy rationale for treating cable telephone services different than the way in which we treat the Internet?

The answer may be, yes, but if there is a difference, what is the predicate for the difference? If there is not a difference, then I suspect we should treat them all the same, I believe is the point that my distinguished colleague from New York makes.

What would your view of that be, Mr. Secretary?

Mr. GUTTENTAG. This is an issue on which we have been working, as I said, with the FCC. Because of the broad spread of these kinds of issues we are talking about, we have I think 18 different agencies involved in sorting out these issues, first deciding where is the best place to address them and then how should they be addressed.

I think this type of legislation that we are dealing with here now provides an opportunity to examine both the tax issues and the very related regulatory issues as to how these industries are going to be regulated and the competitive factors involved in this issue.

So I think that this is an issue that we are still working on. And we would be glad to provide this committee with a statement of exactly where we stand now and what our thoughts are on these issues.

Senator BRYAN. Well, we would appreciate any guidance that you might be able to provide the committee.

[The information provided by Mr. Guttentag appears in the appendix.]

Senator BRYAN. You indicated in the response to I think the Chairman's question that you favor the 3-year versus the 6-year moratorium.

One of the other major differences between the two bills, as you know, deals with the scope of the commission's inquiry. The Senate bill is confined to the Internet, as I understand it. The House bill is much more broadly structured so it would consider the whole concept of taxation in terms of interstate to transactions. Which of the two versions do you favor, the Senate or the House version?

Mr. GUTTENTAG. We believe that it is appropriate to look at all aspects of what we can refer to together as remote sales, that is sales from one jurisdiction into another jurisdiction, whether they are by our more traditional mail order or by an Internet or by in so many cases a combination.

Senator BRYAN. And so I take it, without putting words in your mouth, the answer would be the House version?

Mr. GUTTENTAG. Yes, that is right.

Senator BRYAN. I appreciate that. The record will so reflect it, Mr. Chairman.

And finally, Mr. Scheppach will be testifying later. And I regret that I am not going to be able to hear his testimony. At this point, let me get your response to that, that the moratorium that is created here would in effect preclude the imposition of taxes. One version of the bill would actually preempt the existing taxes then. The House version in effect allows those to remain in effect. But within a year, the States must reenact them.

The point that he makes is that an Internet purchase of airline tickets under the proposed legislation, the Federal Government could continue to impose its airline ticket tax on such a transaction. What is the rationale, if any, for allowing that to occur if indeed what we are trying to do is to impose this moratorium?

And I am asking that question. I am not trying to be judgmental as to which way we should go. But I must say that my colleagues from a previous life do, it seems to me, raised an interesting point that we are saying no to the State, but the Federal Government is permitted to continue to impose the airline tax on tickets that are purchased over the Internet which, as we all know, is a very, very substantial growth area.

Many of our colleagues in this institution, many of our staff purchase airline tickets all the time over the Internet. Again, your response to that, if I might, Mr. Secretary?

Mr. GUTTENTAG. Well, first, certainly, as far as the Federal tax goes, that is a tax which is nondiscriminatory which applies on the purchase of a ticket.

The taxes to which you refer, I am not sure what the kinds of taxes. If you, for example, use the Internet and there is a tax on the access to the Internet, that is the kind of issue which we think requires further study. And there should be a moratorium. It is taxes which in some way discriminate because the transactions on

the Internet. And that is why we are looking at such taxes as the bit tax.

The question could arise, Mr. Bryan, where you have an airline in one jurisdiction, customers, banks, and others, how many jurisdictions would be involved in the sale of that ticket? Those are the kinds of issues that we believe should be examined during the next three years.

Senator BRYAN. Well, I would agree. And I know that my time is up, Mr. Chairman, and you have another series of panels. I agree that we certainly do not want to permit unfair or discriminatory taxes.

On the other hand, by implication, we are suggesting here that any tax that the State would impose would, per se, be discriminatory. I do not think that is necessarily a valid premise. And I think that the National Governors' Association does make a point here that in effect we do not apply the same standard at the Federal level.

When I was a child, my mother used to say, what is sauce for the goose ought to be sauce for the gander. Apparently, we are not following that in terms of any limitation we would impose upon ourselves. I thank you very much, Mr. Secretary for your responses. Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you, Senator Bryan.

And gentlemen, we appreciate your being here. And we look forward to continue working with you on this important matter.

Our next panel consists of Mr. Francis J. Kelly who is Vice President and Head of Government Affairs, Charles Schwab and Company, Washington, DC, and Ms. Jill A. Lesser who is Director of Law and Public Policy, Associate General Counsel at America Online, Washington, DC.

Mr. Kelly, would you proceed? And then, we will call on you, Ms. Lesser.

**STATEMENT OF FRANCIS J. KELLY, VICE PRESIDENT AND HEAD OF GOVERNMENT AFFAIRS, CHARLES SCHWAB & CO., WASHINGTON, DC**

Mr. KELLY. Thank you, Mr. Chairman. Chairman Roth and distinguished members, my name is Frank Kelly, Vice President and Head of Government Affairs at Charles Schwab and Company. I want to thank you for this opportunity to discuss the growth of the Internet and the various tax and trade issues of concern to the on-line brokerage industry.

In just over 2 years, Charles Schwab has become the largest on-line brokerage firm in the world, with the most active web commerce site for retail consumers in the Nation. In fact, in terms of overall volume, we have become the largest online business, finance or otherwise in the world.

Investors buy and sell more than \$2 billion in securities each week through Schwab's web site. During the first quarter of 1998, Schwab's web site handled \$26.2 billion of securities transactions.

The Internet is the next great frontier in the securities market. And we are crossing that frontier now. However, we are gravely concerned that this exciting new means of universal commerce is going to be greatly hindered by burdensome and complicated taxes



that would stunt its growth and potential while significantly diminishing the savings and investments of millions of Americans.

Online brokerage is the leading business to be conducted on the Internet. Online brokerage creates tremendous value for investors by providing instant access to current market news, quotes, account balances, trading, SEC filings, consensus earnings estimates, stock prices, analytical tools, insider activity, and industry reports.

It allows investors to make more informed decisions by providing access to information, such as mutual fund evaluation and analyst recommendations for stocks.

In 1997, Piper Jackorey estimated that online brokerage accounted for 17 percent of all retail trades which more than doubled the 1996 share. Investors placed an average of 192,000 trades per day over the Internet during the first quarter of 1998. This is up from 153,000 per day for the last quarter of 1997, a 25 percent increase in just a few months.

Bill Burham, a former analyst at George, Morgan, Renfeld now with CS First Boston, estimates that online trading will account for 25 percent to 30 percent of all retail trading in 1998.

At Schwab during the second quarter of 1998, online trading accounted for more than 52 percent of all of our retail trades. This works out to an average of 66,000 daily online trades at Schwab alone.

Another analyst, Jim Marks, predicts the number of online trading accounts will soar to 25 million over the next five and a half years, up from 4 million today.

At Schwab, our transformation has created profound new value for our customers. When we began to focus strategically on the online services in 1995, we had approximately 200,000 accounts that traded via our proprietary, PC-based software. Today, we have over 1.8 million active online accounts managing over \$128 billion in individual savings and investment just over the Internet.

In the first half of 1998, Schwab opened up a total of 705,000 new accounts total. Of those, 600,000 are new online accounts representing an additional \$80 billion in assets managed over the Internet.

Of special interest I believe to this committee, of the 705,000 new accounts opened so far this year, 140,000 are Roth IRAs, a vast majority of which are managed over the Internet. Overall, we have opened 340,000 total IRA accounts alone this year.

Today, there are over 60 online brokerage firms. According to Time magazine, commissions from electronic trading were \$700 million in 1997 and will easily exceed \$900 million this year.

What is the benefit of online brokerage to customers? There is several. Lower cost, the average cost per trade has been reduced dramatically since the advent of the Internet. In 2 years ending in 1997, the average commission ticket price has dropped by 70 percent, a huge savings for online investors.

The Internet provides better access to information. We have customers now who get real-time quotes at a rate of 3.6 million requests for real-time quotes per day. It provides convenience. Online investors can check their account balances, analyze a potential investment, and place an order for trade day or night, 24 hours a day, 7 days a week.

The convenience of online trading makes it more accessible to all types of traders from the active daily trader to the buy-and-hold investor who wants to monitor his progress periodically.

Our online customers as well as all our customers at Schwab are free to take advantage of all of our channels, including our call centers and branches. In fact, even if the Internet grows exponentially, we continue to open branches at a rapid pace. The newest one in Reston, Virginia.

And finally, the Internet provides the customers with control. Investors no longer have to feel that investing is a mysterious process. The Internet gives investors the ability to make informed decisions about their financial future, chart to their own course, and monitor the results.

Clearly, the Internet is becoming a key medium that Americans are increasingly becoming comfortable with to actively manage their personal financial matters. We expect to continue growing at an extraordinary pace in the next decade.

I commend the Finance Committee for holding this hearing to discuss the growth of the Internet and various tax and trade implications that have arisen with its growth. I would be delighted to answer your questions.

The CHAIRMAN. Thank you, Mr. Kelly.

[The prepared statement of Mr. Kelly appears in the appendix.]

The CHAIRMAN. Ms. Lesser, will you please proceed?

**STATEMENT OF JILL A. LESSER, DIRECTOR, LAW AND PUBLIC POLICY AND ASSISTANT GENERAL COUNSEL, AMERICA ONLINE, WASHINGTON, DC**

Ms. LESSER. Mr. Chairman and members of the committee, thank you for the opportunity to appear before you this morning. My name is Jill Lesser. And I am the Director of Law and Public Policy and Assistant General Counsel at America Online.

I have been asked to speak to you this morning about the Internet and electronic commerce or e-commerce as it is more commonly known. But before I get into a discussion of why it is that we at America Online believe the interactive medium is going fundamentally to change the way citizens communicate and educate themselves and consumers buy goods and services in this country and around the world, I would like to offer a personal snapshot of what e-commerce can mean to the average consumer.

I shopped online for the first time early this year. I was and still am a new working mother. And as I am sure you can appreciate, working crazy hours and finding myself less and less prepared for the challenges a growing baby presents. I needed a high chair. And I needed a stroller. So I went online at 10 p.m. one night. I compared prices and products. And a couple of clicks of the mouse later, I had bought exactly what I wanted and I have never left my living room.

Online commerce was a revelation for me. What it is becoming is nothing short of an economic revolution for businesses and their customers. And the number of connected consumers grows each and every day.

The Internet is becoming a central part of the social and economic life of people all over the world. By the end of 1997, in fact

more than 100 million individuals worldwide were connected to the Internet. Some estimates suggest that there will soon be 1 billion users worldwide.

Closer to home, 23 million American households and millions of businesses, schools, libraries, and other institutions have access to the Internet. And that number is growing rapidly.

Network traffic itself continues to double every 100 days. In fact, AOL alone processes more than 32 million pieces of electronic mail to approximately 105 million recipients every day. And there are over 800 million visits to the worldwide web through AOL each day.

Americans are using this medium as a source of information, a tool for education, a device for entertainment, a means to build community, and a place to conduct commerce.

Our own members use AOL for a variety of different services every day from checking out online content and chat to e-mail and visits to the worldwide web and more. Increasingly, a significant percentage of the activities that our members engage in online include researching and purchasing products.

Like everything else in this medium which seems to move at lightning speed, online commerce is gaining wider acceptance and momentum within the mass market. Online consumer sales are projected to reach \$20 billion by the year 2000. And according to research by the Gartner Group, that is an increase of over 233 percent over this year's estimated \$6.1 billion.

A commercial revolution is underway, redefining the way goods and services are bought and sold. According to Commerce Department figures by the year 2002, \$300 billion worth of business-to-business commerce will also be conducted online.

The information technology industry represents 25 percent of the real economic growth in the U.S. over the last 5 years. It generates over 8 percent of our gross domestic product, 7.4 million jobs paying 60 percent above the private sector average, and will create another 1.3 million jobs over the next 10 years.

Consumers are migrating to this medium to meet their commerce needs for many of the same reasons that I went online to shop for the first time this year. It is convenient. It is fast. And there is an ever-growing selection of goods and services offered online.

And consumer confidence about the security of online transactions is steadily increasing as well. I should point out that secured technologies within our marketplace as well as the 100 percent total satisfaction guarantee that we offer at AOL have gone a long way to allay consumer worries about the security of online commerce.

In fact, more than 40 percent of AOL's 12 million members have taken advantage of online shopping and almost 80 percent have window shopped. With today's technology, we have been able to change the methods and economics of retailing. And we are starting to see online products and services which are far better than their off-line counterparts offering greater selection, better information, lower prices or different features.

Longer term, the benefits of transacting online will stimulate a consumer behavior shift away from bricks and mortar stores, paper checks, bills, and written signatures to a world of digital informa-

tion and identity storage which has the capability to change how we exchange funds, contract for services, purchase and sell products.

Let me give you two examples that demonstrate how e-commerce is changing the face of the retail environment. Recent one-hour promotions on AOL attracted more than 50,000 members to the preview travel site of \$99 fares and more than 30,000 to the music boulevard site for the Titanic sound track. Can you imagine a bricks and mortar store accommodating the crush of 30,000 customers in one hour?

And with all due respect to my good friend and colleague, Frank Kelly from Charles Schwab, AOL's personal finance area has become a popular destination in cyberspace that enables members to do everything from managing stock portfolios to paying bills online. AOL's personal finance area has 5 million regular users, hosts 6 million accounts, and serves up to 75 million stock quotes a day.

Mixed in with all this good news and excitement that accompanies the tremendous growth and potential of electronic commerce is the very real fact that there are significant challenges to the growth of this medium.

And the subject of this hearing is one of them. As the committee knows, many tax administrators in State and local taxing jurisdictions have been busy reinterpreting existing statutes that apply to old media to find new sources of revenue in the Internet.

We believe the Internet Tax Freedom Act which is before this committee will help the Internet and e-commerce grow and will stop the stem of these new taxes until we can have a consistent system in place to address definitions.

I appreciate the opportunity to be here. And I am certainly willing to answer an questions you might have. Thank you very much.

The CHAIRMAN. Thank you very much, Ms. Lesser.

[The prepared statement of Ms. Lesser appears in the appendix.]

The CHAIRMAN. Mr. Kelly, has the Internet made savings vehicles more available to individuals, especially younger ones?

Mr. KELLY. Very much so. We have found that the average, non-Internet customer at Schwab is approximately 45 and has no more than \$27,000 in savings invested, but with the Internet, that has been significantly lowered. It is much more the twenties and the thirties set. And they do not have that much money now, but they are putting it away pretty frequently. So, yes.

The CHAIRMAN. Well, what is the typical profile of your customers that use the Internet?

Mr. KELLY. They tend to be in their twenties, approximately I believe about \$50,000 to \$60,000 per year. Many of them are single. And many of them tend to go for mutual funds because of a higher rate of return.

Senator MOYNIHAN. Roth IRAs?

Mr. KELLY. Roth IRAs, yes, Senator.

The CHAIRMAN. Is that number one? [Laughter.]

Mr. KELLY. Actually, Senator, I am glad you asked that. It is one of the highest visited sites that we have on our web site next to just the overall trying to figure out how to save is the next one.

The CHAIRMAN. Ms. Lesser, would you comment on the typical customer?

Ms. LESSER. Actually, our customer base is really very varied because we at America Online cater not only obviously to those people who are doing business and investing, but particularly families. And so we have a lot of people from their twenties to their thirties and forties who are trying to build community and bring their children online as well.

The CHAIRMAN. Mr. Kelly, do you foresee a time when security transactions will be done primarily over the Internet?

Mr. KELLY. I think there will always be the need for brokers. Some people may like that. And that is why we continue to build our branches. But it looks like there is a very significant of that. If the rate of growth continues, yes, a significant amount will be done over the Internet.

The CHAIRMAN. And what has been the economic impact of the use of the Internet with respect to business transactions for your company? Have consumers received any economic benefit?

Mr. KELLY. Well, yes, because it is cheaper. And that is primarily why they go. Many of our competitors can charge as much as \$200 per transaction to deal with a broker over the telephone. Whereas, we can charge \$29. And I dare say we have, not to plug the competitors, but there are many other discount brokers online, at least 60 other brokerages that I have mentioned that charge as little as \$7 for a transaction.

The CHAIRMAN. And what are the tax differences, if any, between a transaction that takes place over the telephone versus one that takes place over the Internet?

Mr. KELLY. Essentially none. Our customers continue pay capital gains and dividend tax on any transaction if they make it.

The CHAIRMAN. Ms. Lesser, there have been more and more incidents of the Internet crashing. Do you feel that the Internet will become saturated and overloaded or that these troubles can be overcome with new technology? What do you think will happen in the year 2000?

Ms. LESSER. Well, Senator Roth, the Internet obviously, use of the Internet has grown exponentially. And from time to time, some of the systems that either provide access to the Internet or very, very busy sites on the Internet have certainly gotten clogged up so that customers have been frustrated either because they cannot get online or once they try to go to a site on the web, it takes a long time to get there.

But the beauty of the Internet is that it is in fact limitless and that all we need to do is add new capacity, new computers, new lines. And we are unlikely to see a system crash as you describe it because it is, as many describe it, a network of networks. So it is not located in one place. It does not rely on one central system. And therefore, it really does have the capacity to continue to grow.

The CHAIRMAN. What are the various facets of Internet use that either have been or could be taxed at the State, Federal, or international level?

Ms. LESSER. Well, really they probably fall into two general categories. And the bill in front of you addresses both of those categories. One is the taxation of access to the Internet or the taxation, for example, on the \$21.95 a month that most of our customers pay to have unlimited online access.

The second piece of it is taxation on transactions conducted over the Internet, so people who place orders in the same way they might to an L.L. Bean and receive products in the mail or in the alternative people who buy things directly online, products that can be delivered digitally, for example, software. And taxation of both of those kinds of categories already exists.

In terms of addressing the issues that we are trying to address with this bill, obviously we want to make sure that the Internet is not taxed in an discriminatory manner and that the tax treatment of both transactions over the Internet and access to the Internet makes getting onto the Internet basically neutral so that consumers are not paying more if they are transacting their business or conducting communications online.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman. And where are these different taxes and how do they get collected, could I ask Ms. Lesser and Mr. Kelly? I am thinking of New York State or New York city I believe. I do not know whether either one or both still have a stock transfer tax.

When someone buys a share through one of your systems, will that tax be collected and remitted or not because you are not in the jurisdiction of New York State?

Mr. KELLY. That is a very good question.

Senator MOYNIHAN. I am just thinking of Wall Street.

Mr. KELLY. That is a very good question. I mean, we have—

Senator MOYNIHAN. I do not know how many of these taxes there are, but—

Mr. KELLY. Actually, I am not aware of any State taxes on securities at the moment, though there has been. There is—

Senator MOYNIHAN. There is a city one in New York. Is that it?

Mr. KELLY. I believe so, Senator, yes.

Senator MOYNIHAN. I think I am sure, yes.

Mr. KELLY. I believe so. But that is a very good question of what happens if you are trading on Schwab online which I hope you are and that you travel to California and you check your portfolio on your laptop and you decide to transact. Are you subject to that or not? And this is why we would like to see a 3-year moratorium to figure out how we are going to work this out.

Senator MOYNIHAN. I see. This is not a question you think the commission should address?

Mr. KELLY. Exactly. Exactly.

Senator MOYNIHAN. Let us see. Where am I? I am in California. And I have a laptop.

Mr. KELLY. I can even make it more confusing for you, Senator.

Senator MOYNIHAN. I check out my portfolio. But what if there is a beach?

Mr. KELLY. I would hope you would be there. [Laughter.]

Senator MOYNIHAN. Ms. Lesser, is that—

Ms. LESSER. Actually, America Online does not directly engage in securities transactions.

Senator MOYNIHAN. All right.

Ms. LESSER. So I cannot answer your specific questions, but—

Senator MOYNIHAN. But persons will though.

Ms. LESSER. That is right. That is right. And I can tell you as Mr. Kelly did that certainly our position is to make sure that the commission during this moratorium figure out questions like that.

But I will tell you that any taxes—America Online believes philosophically that any taxes that are collectible if that transaction took place off-line should be collectible if that transaction takes place online.

Senator MOYNIHAN. Mr. Chairman, very straightforward answers. And I appreciate them very much. I think that is something we would want to—well, among the charges to a commission if we have one, this should be included.

The CHAIRMAN. Thank you, Senator Moynihan.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. I must say, I am a little confused here. There some portrayal of this as a new industry, it is a sort of an infant in swaddling clothes practically, but it is a surging industry right now.

I was looking at your statement, Ms. Lesser. And network traffic continues to double every 100 days. In fact, AOL alone processes more than 32 million pieces of e-mail per day. On it goes, by the end of 1997, more than 100 million individuals worldwide were connected to the Internet. Some estimates suggest there will 1 billion users worldwide. And on you go, online consumer sales are projected to reach \$20 billion by the year 2000. That is an increase of 233 percent over this year's estimated \$6.1 billion.

And I am just not quite sure why you are here, why we are all here, to tell you the truth. I do not see why the suggestion is that you should not be taxed and yet telephone taxes are perfectly all right. Every State imposes telephone taxes.

Senator MOYNIHAN. As does the Federal Government.

Senator CHAFEE. As does the Federal Government. And it seems to me you are thriving. I suspect your boss, Ms. Lesser, the head of AOL is making a handsome salary every year. What do you think he is making? [Laughter.]

Ms. LESSER. I am sure you will not be surprised if I do not answer that question.

Senator CHAFEE. Well, I do not know, but I would be willing to admit that it is more than a Senator makes. So why are you here?

Ms. LESSER. Let me answer that question. First of all, we are not here claiming that we are an infant industry. I mean, I am sure we could debate over whether we are in our toddlerhood or our adolescence, but suffice it say that obviously that the industry is growing.

And we are also not here to avoid paying taxation or to set up a system ultimately that basically holds the Internet as a tax-free zone.

We are here to talk about Internet tax neutrality. And one of the things that my estimates point out is that if there is a system put in place, and we hope at the end of the discussions that a commission that is set up, that there will be a uniformed system of taxation, one that gives guidance about, for example, what it means to be providing Internet access because it seems like a simple question, but it actually is not. We provide many services that go way beyond Internet access.

In addition, where customers should be taxed, how we should collect. Once we solve all of those problems, all of the revenues that I spoke about will actually I imagine be subject to some kind of taxation. And I think tax collection rates will actually increase.

We heard earlier testimony about how low tax collection rates have been from Senator Bumpers in the remote sale area. And this technology may facilitate collection if we have a system of uniformity.

With respect to electronic commerce and not Internet access, we are here again to talk about neutrality and would not want to end up with a situation where goods purchased off-line, for example, over the telephone or through mail order would be taxed differently than something done over the Internet or at a different rate.

And finally, with respect to your question about telecommunications taxes, I think it is important note that all at this point of America Online's access, most if not all of America Online's access is done through telephone lines.

And so telephone lines are either leased or purchased or services are purchased from two ends, both at the consumer end for a line to get online and at America Online's end. Our telecommunications charges total over \$1 billion a year. And we pay taxes on all of those charges as do our customers.

So in terms of accessing the Internet, and this references Senator Moynihan's earlier question as well to Secretary Guttentag, we do pay taxes over the use of telecommunications when we use them as users.

And we believe that with the current system, particularly when some States are also calling us telecommunications services that it would result at this point in double taxation.

Senator CHAFEE. Well, as I understand the bill, it would prohibit the imposition of taxes on Internet access and the moratorium for 3 years. Why should you get that, Mr. Kelly?

Mr. KELLY. Well, Senator, we feel that it would give the commission some time to get up and running and also to examine this. This is growing so fast. It is extremely complicated.

To sort of meld these two questions together, one concern that we have, the online brokerage industry is we are not opposed to paying taxes. And if the government wants to add new taxes, that is fine.

What we are concerned about is we are already—

Senator MOYNIHAN. Say that again, sir. We have not heard that often. [Laughter.]

Mr. KELLY. I am sure a pink slip will be in the office when I return. But we are already paying taxes on each securities transaction. What sort of alarmed us is that there seems to be no uniformity between the States, the counties, the cities on how they are going to start taxing Internet transactions.

And to give you a vivid example I believe, the head of tax policy for the State of Texas testified in front of the House Commerce Committee last year. And during his testimony, he argued that if there is a server in his State through which Internet transactions are routed, he has to a right to tax every transaction that goes through there regardless of the fact it has nothing to do with anybody in the State.



So conceivably, you could sit here and place an order with Charles Schwab and it go out west, who knows, to one of our call centers or to Florida and somehow end up being routed through Texas. And he could put a tax on that just for passing through.

Senator CHAFEE. Well, I mean, I think there should be some uniformity here. And I notice the word "discriminatory" comes up frequently. I am not sure just what it means. I suppose that you would not have to pay a higher tax for your stole that you bought if you bought it over the Internet than if you went to the store and bought it directly, this local sales tax.

Ms. LESSER. That is right.

Senator CHAFEE. But I must say I do not think you folks are suffering very much. I mean, your very accounts sound like you are thriving and growing at a tremendous clip. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

Ms. Lesser, you said that as a matter of policy, you felt that transactions through the Internet should be taxed in the same way that they would be taxed if they were in a more conventional commercial setting?

Ms. LESSER. That is correct.

Senator GRAHAM. So is the need for a 3-year delay in implementing that policy because this is a technologically complex issue as to how to carry out that policy?

Ms. LESSER. Actually, with respect to electronic commerce transactions, the bill at least as it was modified in the House of Representatives, H.R. 4105 which represents a compromise, it would only—the moratorium would apply to discriminatory or multiple taxes on electronic commerce.

So if the taxation—if the transaction were treated the same online as it were off-line, the moratorium would not go into effect and those taxes would be collected during the 3 years.

So to answer your question there would be no moratorium on those taxes. We want to make sure, for example, if I had to pay 7 percent online and 6 percent off-line that it would be equalized during the moratorium.

Senator GRAHAM. What is the current practice in terms of if I am an user of America Online in Tampa, Florida and I use your services to buy a product from a stroller manufacturer in Pennsylvania, how is that transaction currently treated?

Ms. LESSER. All right. In that situation, you would unlikely be purchasing a product directly from America Online because we do sell some of our own products for which we do collect sales tax in many States, but we also obviously provide people with access to the Internet through which they can—for example, in my case, I purchased from Internet Baby. And they can purchase from a company that has a web site.

If that company is located in Pennsylvania and you are a Florida customer and that company has no place of business or connections with the State of Florida, then under existing law on remote sellers, the State of Florida would not be able to impose a collection obligation on that Pennsylvania business.

That situation would be exactly the same if you called Internet Baby on the phone or sent them a check or something through the mail.

Senator GRAHAM. But under Florida law, I as the purchaser under the sales and user tax concept—

Ms. LESSER. Tax.

Senator GRAHAM. I would be responsible for the tax if the seller was not responsible. How—

Ms. LESSER. That is exactly right. And that is exactly the same in the Internet context.

Senator GRAHAM. And how does the Internet facilitate the collection of that tax which is owed by the purchaser in Tampa?

Ms. LESSER. Actually, my reference to facilitation was to the tax collection so on the part of America Online or another company. I am not sure and actually have not even given any thought to the notion of the facilitation of collection of use taxes.

As I am sure you are well aware, use taxes have been historically very, very difficult to collect. And collection rates have always been very low. And that perhaps may be one of the issues that the commission might look at and sort of how to address collection in the use area.

Senator GRAHAM. But it would seem to me—and I would confess that I am trying to reach the point of literacy with the computer to know how to turn the machine on. I have not quite gotten there yet.

Ms. LESSER. It is just a button. I mean, it is just up, down.

Senator GRAHAM. There are a lot of buttons. I have got to get directed to the right button. It would be seem to me that in fact this technology would make it easier to accomplish that user tax responsibility in collection.

Ms. LESSER. Right. It may very well. And again, the taxes that we are talking about, both the access taxes and the electronic commerce transaction taxes are ultimately the responsibility of the consumer. And we in that situation are acting as the tax collector.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Grassley.

#### OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Mr. Chairman, I do not have any questions, but I would like to take just a little bit of my time to express my view on the subject. And we obviously, we can tell from the statements that have been made by our colleagues and these two witnesses as well that this is a very complicated issue.

And we see ourselves caught between trying to make decisions in Washington for local and State governments and whether or not that would be an impediment for technology. And obviously, we do not want to stand in the way of technology.

And I think we are seeing this change at a pace that is difficult for public policy to keep up with it and much less get ahead of it. And the regulation of taxation of the Internet, of course, as we are finding out from this hearing is a very complex issue and that we must be aware of unattended consequences.

Almost every sentence that we have heard in testimony today can tell about unattended consequences that we should maybe be aware of in Congress and this hearing is to make us aware of it, but obviously I have to confess I am not aware of all of these consequences.

So this, Mr. Chairman, might not be a very interesting hearing to have because of the nature of the technology, but it sure is a very necessary hearing to have so that we do not interfere with the economy and with the technology.

I would like to express concern about some of the issues that it is important that we keep the tax burden on working Americans as low as possible. That is a philosophical point that a lot of us in this committee would have. And it is not necessarily saying that we are in support of the legislation when we say that, but that obviously ought to be of some concern to us.

And I would also want to make sure that we promote the development and the use of new technology. On the other hand, the Federal Government making such dictates the State and local governments makes me uncomfortable because I do not believe that we have all the knowledge in Washington, DC. In fact, sometimes, you find an awful lot of Washington nonsense that we need grassroots common sense from middle America to set this nonsense straight.

I also want to make sure that mom and pop stores on main street America are not unfairly disadvantaged by government tax schemes. We need to study this problem, but we do not need to take as long as some people might want us to take to study it.

I simply do not see why we need a 6-year moratorium when it seems to me that maybe 3 years would be more than enough. The IRS commission that I served on had only 15 months from its first meeting until the time that we had to submit a report to the Congress that finally is legislation getting to the President's desk.

If we can reform and restructure the entire IRS in less than 3 years, surely we can work with this problem of the Internet and Commerce on it in that same period of time.

In addition, I believe that it is important that we need to pass a bill that satisfies it to the extent we can and if we get everybody at the table, work out something amicably.

It would be better if we could get not only a compromise between the segments of our society, segments of our Federal system of government, and also a bipartisan compromise. So that is where I am coming from and it is one of learning a lot from this meeting. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Grassley.

Well, we appreciate both of you being here very much. And I think your testimony has been indeed helpful to the committee. Thank you very much.

Mr. KELLY. Thank you, Senator.

The CHAIRMAN. We will now call upon the final panel who will discuss the current compromise that it is being worked by the State and local governments, as well as the Internet business community.

Our panel consists of Mr. Harley T. Duncan, Executive Director of Federation of Tax Administrators, Washington, DC; Mr. Mark E. Nebergall, the Internet Tax Fairness Coalition; Mr. Raymond C.

Scheppach, Executive Director of the National Governors' Association; and Mark A. Micali, Vice President, Government Affairs, Direct Marketing Association.

Mr. Duncan, we will start with you and move to the right.

**STATEMENT OF HARLEY T. DUNCAN, EXECUTIVE DIRECTOR,  
FEDERATION OF TAX ADMINISTRATORS, WASHINGTON, DC**

Mr. DUNCAN. Thank you very much. Mr. Chairman and members of the committee, thank you for the opportunity to appear before you this morning on S. 442 and H.R. 4105, two different versions of a measure called the Internet Tax Freedom Act. My name is Harley Duncan. And I am the Director of the Federation of Tax Administrators which is an association of the tax administration agencies in the 50 States, the District of Columbia, and New York City.

Our policy regarding these measures was established in resolutions adopted unanimously by our membership at its last two annual meetings.

The summary position of our organization is that if the committee feels legislation of this sort is warranted, we would urge you to adopt the basic approach and general features contained in H.R. 4105 with several modifications, as opposed to the approach contained in S. 442. We presented a detailed statement that contains our rationale for this.

Based on our policy statements, there are three general points I would like to make this morning. These are essentially tax policy or tax administration principles that we would urge you to keep in mind as you deliberate this issue and consider the legislation.

First, any legislation that you pass should be prospective only and should not preempt the taxes that are currently imposed by State and local governments on various aspects of electronic commerce.

You can adhere to this principle and meet the challenge of no new taxes on the Internet which has been the stated public purpose of the supporters of the measure.

The primary issue in this regard is the tax on Internet access charges that is now imposed in 11 States, the District of Columbia, and an equal number of Colorado cities. We see no reason that these taxes should be preempted. They are legitimately imposed through the processes implied in the States. They have been administered in accord with the law.

If taxpayers feel aggrieved, there are avenues of appeal. And they apply to an essential local activity. In this regard, all Internet service providers have been treated just like all other taxpayers. And this activity has been treated like all other matters subject to State tax.

S. 442 would preempt taxes on Internet access effective on the day of enactment in all States that currently do so. H.R. 4105 would preserve those taxes in some States under certain circumstances. We would urge you to re-look at this issue and enact a grandfather that would preserve all current State and local taxes on Internet access.

The second principle we would ask you to consider is that any legislation you pass should not affect the tax liabilities that have

arisen under State and local tax laws that were appropriately imposed prior to the date of enactment of any Federal legislation. In other words, any bill you should pass should have no retroactive effect as to the liability under current State law.

The language in each H.R. 4105 and S. 442 is potentially problematic. It prohibits attempts to assess, collect or attempt to collect taxes on particular activities, particularly Internet access charges after the date of enactment.

We believe that without clarification, this could be used to thwart efforts to really administer taxes that were perfectly legitimately imposed on activities that occurred prior to the enactment of the Federal legislation.

This would be patently unfair to the majority of Internet service providers that understood their obligations, collected the tax, and remitted it, if you were to pass a bill that a retroactive application and really provided a Federal absolution for some Internet service providers who would not comply with their obligations.

We think you can cure this by ensuring that any prohibition under taxation of Internet access services be limited to those services that are delivered on or after the date of enactment of the bill.

The third principle that we would ask you to consider is that any legislation which imposes limits on the State and local authority should address specifically the types of taxes which are intended to be prohibited or the activities which are intended to be circumscribed rather than imposing a broad prohibition on State and local taxation and then allowing certain exceptions to the prohibition.

In this regard, H.R. 4105 is clearly preferable to S. 442. H.R. 4105 says exactly what it does not want which is new taxes on Internet access, multiple and discriminatory taxes that are really relatively clearly defined terms, and then it speaks to bit taxes and the like.

S. 442, on the other hand, is a broad prohibition on all taxation of communications or transactions occurring through the Internet as well as online services and access. The effect of S. 442 I think would be to create litigation in which the State is required to show that it comes within the four corners of any of those exceptions. And it is likely to have unattended affects of preempting taxes that you had no intent of doing that.

In closing, I would just ask that we keep our eye on the bigger picture beyond the technical details and nuances of taxation of Internet access or multiple or discriminatory taxes. The central issue here is the long-term survival of State and local sales taxes.

We would urge the Congress to consider and use this bill as an opportunity to put in motion a process that calls for a serious examination of a substantial revamping of sales tax administration to make it simpler and more uniform across the States and in return to require a collection of those taxes that are legitimately due and owing by a broader range of remote sellers. In doing so, I think you can achieve a bill that enjoys substantial support from State and local governments, as well as the online industry. Thank you.

The CHAIRMAN. Thank you, Mr. Duncan.

[The prepared statement of Mr. Duncan appears in the appendix.]

The CHAIRMAN. Mr. Nebergall.

**STATEMENT OF MARK E. NEBERGALL, THE INTERNET TAX FAIRNESS COALITION, WASHINGTON, DC**

Mr. NEBERGALL. Thank you, Mr. Chairman and members of the committee for the opportunity to appear before you today to discuss the views of the Internet Tax Fairness Coalition on the subject of legislation on tax and trade issues related to the Internet, including S. 442 and H.R. 4105. I am Mark Nebergall. I am Vice President and a counsel for the Software Publishers Association.

The Internet Tax Fairness Coalition, Mr. Chairman, is a coalition of leading Internet and high-tech companies and trade associations that represent hundreds of companies that support the fair and equitable tax treatment of the Internet and online services.

The coalition believes Congressional action is necessary to implement a moratorium to address Internet-related tax issues. It members include companies, such as IBM, Symantec, Ticketmaster, and trade associations, such as the U.S. Chamber of Commerce, the National Retail Federation, and the Software Publishers Association.

The Software Publishers Association is the leading software industry trade association. SPA has 1,200 member companies ranging from the largest and best known software developers to many other smaller firms.

Its members develop and market software that enables the Internet to operate. And its members also utilize the Internet as a low cost media for distribution of digital products.

We have submitted a written statement and ask that it be made a part of the record of these proceedings.

The CHAIRMAN. Without objection.

[The prepared statement of Mr. Nebergall appears in the appendix.]

Mr. NEBERGALL. Thank you, Mr. Chairman, the Internet Tax Fairness Coalition believes that as a general matter that existing rules developed with regard to taxation of traditional commerce are adequate to accommodate commerce conducted using the Internet.

However, with regard to sales taxes on Internet access charges, there are no existing rules. The problem is that some State tax administrators are trying to fit a square peg into a round hole by taking decades old sales tax laws that apply to unrelated services and apply them to this new technology. The result has been widespread confusion and uncertainty regarding the obligations of companies that provide this new service.

The solution to this problem is the Internet Tax Freedom Act. This legislation would impose a moratorium on State sales tax on Internet access charges only for a period of time to allow the development of consistent rules and to eliminate the confusion.

On the other hand, Mr. Chairman, existing rules are sufficient to accommodate sales taxation of products purchased using the Internet. These transactions are no different from traditional mail or telephone sales.

However, many vendors hesitate to begin offering their products for sale on the Internet because they fear that States will treat Internet sales differently from mail or phone sales. This environment of uncertainty deters many companies from venturing onto

the Internet as a low-cost marketing and product distribution channel.

The Internet Tax Freedom Act will help solve this problem by giving small business comfort and assurance that Internet transactions will be treated the same. All versions of the Internet Tax Freedom Act would require during the period of the moratorium that States treat Internet sales the same as mail order and telephone sales.

It is important to note that the provisions of H.R. 4105 recently passed by the House of Representatives are a compromise reached between the Internet Tax Fairness Coalition and State and local government groups after extensive negotiations.

I was a member of the negotiating team deputized by the coalition to meet with representatives of the State and local governments. In fact, this panel feels kind of like *de ja vu* all over again because we were part of the negotiating teams.

We spent many hours at the negotiating table resolving our differences. With the exception of the grandfather clause, H.R. 4105 represents legislation that both sides of the table represented that they could support.

The House bill includes a grandfather clause which excludes eight States from the moratorium of State sales taxes on Internet access charges. I fully expect that number to go down to seven if we are to believe Senator Lieberman who indicated that Connecticut is likely to bail off of the list.

The coalition opposed any grandfather clause on the ground that it constituted unsound tax policy to allow some States that were causing the very confusion which formed the basis for the moratorium in the first place to continue to impose their taxes on the Internet access charges.

The States, on the other hand, opposed any limitations on their taxing power, those States that already had moved to assert these taxes.

The bill passed the House represents a middle ground. It allows eight specified States to continue to impose their taxes provided their State legislatures within one year of enactment pass laws that affirm their State's policy to impose taxes that otherwise would be subject to the moratorium.

Mr. Chairman, our coalition also believes that Federal legislation in the United States which mandated neutral tax treatment for Internet sales would send a signal to our trading partners on an important tax policy issue.

Many foreign countries are also struggling with interpretation of their tax laws in light of the explosive growth of the Internet and electronic commerce. There is vigorous debate in international fora on the correct treatment of electronic commerce, both with regard to direct and indirect taxation.

The United States has taken a leadership role in these debates. It would enhance the weight of U.S. advocacy on these issues for the Congress to give its imprimatur to this principle of neutral tax treatment for Internet sales which would result from passage of this legislation.

Last, Mr. Chairman, we note that the House bill, H.R. 4105, gives its commission only 2 years to complete its work. Given the

complexity of the issues we are concerned that this commission will have insufficient time to give the issues the thorough attention they deserve.

We urge you to consider reporting a bill that gives the commission more time to complete its work. We acknowledge that this may require a moratorium longer than the 3 years called for in the House bill.

Mr. Chairman, this completes my prepared statement. And I am pleased to answer any questions that you or the other members of the committee may have. Thank you for the opportunity to appear this morning.

The CHAIRMAN. Thank you.

Mr. Scheppach.

**STATEMENT OF RAYMOND C. SCHEPPACH, EXECUTIVE DIRECTOR, NATIONAL GOVERNORS' ASSOCIATION, WASHINGTON, DC**

Mr. SCHEPPACH. Thank you, Mr. Chairman for the opportunity to appear before you today on behalf of the National Governors' Association. I would like to enter my full statement on the record and summarize it very briefly.

With respect to the Internet Tax Freedom Act, I would like to talk about three major issues: first, to define the nature and extent of the problem; second, to summarize the Governors' position regarding S. 442 and the Gregg-Lieberman; and third, to summarize the Governors' position with respect to the House bill.

First, concerning the magnitude of the problem, there is a lot of rhetoric stating that 30,000 State and local taxing authorities will kill this new industry. The facts are that there are only 11 States, the District of Columbia, and 13 home rule cities in Colorado who have Internet taxes.

In 1997, no State and only one city took action to tax the Internet. And that city repealed its tax within 30 days. Since the beginning of 1997, Florida, Georgia, Maine, and Washington have removed their Internet taxes. And in New York I believe the Governor of Patacki lifted it due to executive order.

In summary, Mr. Chairman, State and local governments are not looking to tax the Internet. In fact, the evidence is to the contrary. They are competing by making it tax free.

The real problem for State and local governments is the inability to tax goods that are purchased by mail order and over the Internet. Currently, States lose about \$4 billion on mail order sales and by the year 2002 will likely lose between \$15 and \$20 billion by not being able to tax remote sales which we define as both mail order and Internet.

While the loss of this revenue is of concern, the real problem is not the loss in revenues. It is the tax advantage given to remote sales that are tax exempt relative to main street businesses who have to pay taxes.

Mr. Chairman, it is not that the individuals who order these goods over the Internet or by mail order do not have tax liability. It is merely that the Supreme Court has said that States cannot compel sellers to collect the taxes. In the Supreme Court decisions, they have actually invite the Congress to in fact fix this problem.



Mr. Chairman, if this problem is not corrected, it will lead to the virtual collapse of State and local taxes which represent about 50 percent of the current State tax base. This is because sales taxes will no longer be fair.

You cannot have a fair tax when your tax rate depends on how you buy the item. It is not equitable tax to have a 5 percent sales tax on an item bought in a local mall and a zero tax rate if you purchase it over the Internet or by mail order.

Mr. Chairman, this is why the scope of the commission and the makeup of the commission are critical to Governors. The commission must focus on all remote sales, both Internet and mail order and it must have representatives of main street.

If you want to have a sense of the potential impact, you might look at the recent Time article. It says kiss your mall goodbye. That just gives you some indication. Now, it is one thing if the malls have serious problems because they cannot compete with the Internet on a normal economic advantage. However, if they have a 5 to 6 or 7 percent tax disadvantage, you are just going to accelerate the main street problem.

So I think the decisions that this committee makes with respect to this legislation is very serious in terms of impacts not only on State and local government, but on main street America.

We also get into a lot of rhetoric about what happens if you are in this State and you purchase something from another State and it goes through four States in a server and you are actually a citizen of a final State? There is a lot of rhetoric, a lot of people trying to complicate this.

The truth of the matter is the tax is at the rate of the State which receives the goods. Wherever the destination is, whatever the zip code is, that is the particular rate that is applied. There is no confusion. There is no disagreement among States on that. It is a use tax. It is by individual destination.

Senator MOYNIHAN. Sir, may I ask, the State that receives the goods?

Mr. SCHEPPACH. Wherever the goods is the destination. In other words, if you in New York city receive the goods and there is no other State that is going to tax you, the taxes would apply to whatever State and local taxes apply in that place. It does not matter where—

Senator MOYNIHAN. If I went on to New Jersey to buy that item, I would pay the tax in New Jersey. Would I?

Mr. SCHEPPACH. If you go to New Jersey, you will pay—

Senator MOYNIHAN. If I have not gone to New Jersey, if I wired New Jersey?

Mr. SCHEPPACH. I am saying it does not matter where the goods comes from.

Senator MOYNIHAN. I see.

Mr. SCHEPPACH. It is just that it is a use tax. It is the State that you receive it in and use it in. And I am just saying that a lot of people are trying to add confusion to this, but there is no disagreement on that. I would also—

Senator MOYNIHAN. I would plead, sir, that there may be some confusion. [Laughter.]

Mr. SCHEPPACH. You think there is still some confusion, sir?

Senator MOYNIHAN. Me, I am confused. That is all right. Now, I know.

Mr. SCHEPPACH. All right. I would also indicate that there are international implications of this. We do see where the commission in the common market has made a recommendation now that the value-added taxes will apply. And I do not think the commission has made a decision, but it seems to be other countries are moving in that direction which we would be inconsistent with.

Let me just make two final comments. The Governors continue to oppose the Senate bills, 442 and the Gregg-Lieberman bill. And the reasons are essentially those are broad preemptions. They have long-term moratoriums. And we think that the commissions are flawed.

The Governors do support a bill that was negotiated, at least a structure of it on the House side. However, there are six or seven technical amendments, some of which Harley Duncan has already talked about that we would like to see to help correct some of the drafting or other technical considerations. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Scheppach appears in the appendix.]

The CHAIRMAN. And now, we will call on Mr. Micali.

**STATEMENT OF MARK A. MICALI, VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION, WASHINGTON, DC**

Mr. MICALI. Thank you, Mr. Chairman. Mr. Chairman, Senator Moynihan, members of the committee, thank you very much for this opportunity to testify regarding the Internet tax legislation. My name is Mark Micali. I am Vice President of Government Affairs for the Direct Marketing Association.

The Direct Marketing Association represents 3,700 member companies, both domestically and internationally who sell goods and services through mail, telephone, and now the Internet. We want to go on record as very strongly endorsing both the Gregg-Lieberman bills and the McCain-Wyden bills as a very good solution to the question of Internet taxation.

Currently, we understand majority leader Lott is working on marrying together, to use Senator Lieberman's word, the Gregg-Lieberman and the McCain-Wyden bills. We think this is a very effective merger. You will have a moratorium on the Internet access taxes principally from the McCain-Wyden bill and a commission whose jurisdiction is one of resolving issues of various State laws which are often in conflict in how they deal with the Internet.

As was noted in earlier testimony, the Internet is viewed as a computer service in some States. It is viewed as telecommunications in others. And we think the commission involved in the Gregg-Lieberman bill would address those issues and propose model State law for all the States to adopt and to avoid some of the confusion.

I would also like to make clear for the record the Direct Marketing Association's position on the legislation which passed the House, H.R. 4105. The Direct Marketing Association negotiated in

good faith with a number of the people here at the table with me. We were requested by chairman Henry Hyde, the chairman of the Committee of Jurisdiction in the Judiciary Committee to negotiate. And whatever was agreed during our negotiation, we had agreed not to oppose as it traveled through the House. And we did not oppose it. And that legislation passed through the House.

But from the outset of those negotiations we were unequivocal. And I think chairman Hyde would corroborate this statement that we supported the Gregg-Lieberman and McCain-Wyden legislation. And it was our hope for the Senate to enact those bills and that they ultimately be enacted into law.

In particular, the House-passed legislation cedes to a commission the question of interstate sales tax collection. The House-passed measure grants to a commission the authority to recommend policy on the question of mandatory interstate sales tax covering Internet, mail, and telephone, a matter which has and continues to be in the jurisdiction of the Congress and in the case of the Senate here in the Finance Committee.

The Supreme Court decisions that were noted earlier, Bellis Hess and Quill, particularly Quill was unequivocal in saying that Congress would have the power to determine anything regarding interstate sales tax.

Congress has decided over the years not to grant States the power to require a company that does not have presence in a State to collect tax in that State. We think Congress has been correct in that decision. And we want the Congress to continue to have that exclusive power.

In endorsing the Gregg-Lieberman and McCain-Wyden legislation, we think the Congress would have achieved an important goal: a time-out, a federally-imposed time-out on taxation of Internet access and a commission whose job is limited, but carrying out a very good public policy, trying to harmonize State laws that frankly and in fairness to the drafters of those State laws never even conceived of the Internet when many of them were written.

Accordingly, the Direct Marketing Association urges this committee to support the efforts of merging the Gregg-Lieberman and McCain-Wyden bills. We think the Senate, first this committee and then the full Senate should adopt that. And we think a number of important policy goals will be achieved.

As was noted earlier by Senators Wyden and Lieberman, you will promote entrepreneurialism, you will not saddle it with taxation. And really I think the bottom line of all of this would be a situation whereby our economy will continue to grow and I dare say Federal revenues and State revenues will be larger with a stronger economy and a stronger growth of our Internet and those companies that sell via the Internet.

Mr. Chairman, thank you very much for this opportunity. And I would be glad to answer any questions.

[The prepared statement of Mr. Micali appears in the appendix.]

The CHAIRMAN. I would like to ask each one of you, in defining what type of taxes are included in the moratorium, the House and Senate bills take a different approach. The House bill lists specific taxes that would be included in the moratorium. The Senate bill prohibits all taxes on Internet-related transactions and communica-

tion, but then exempts specific taxes. I would like to ask each one of you which approach is preferable and why?

Mr. Duncan.

Mr. DUNCAN. We strongly prefer the approach taken in the House bill. We believe that if Congress wishes to circumscribe State taxing authority, they should be specific and specify those taxes that they do not want. And that is done in the House bill through fairly precise definitions, as you noted.

The concern we have with the Senate bill is simply that the broad prohibition within certain stated exceptions shift all the risks, ambiguity, and burden to the States. And we expect that it would promote litigation. And they would have to show that they come within the four corners of each of those exceptions.

The problem that you then create in applying one set of rules to 50 diverse tax systems is that they are going to be unintended consequences in States that do not come within the four corners of those exceptions. And you would have preempted taxes that you did not intend to.

The CHAIRMAN. Mr. Nebergall.

Mr. NEBERGALL. Mr. Chairman, the Internet Tax Fairness Coalition is indifferent as to the approaches taken by either S. 442 or H.R. 4105. We believe that the approach taken in the Senate bill reaches precisely the end point as the approach taken in the House bill. They just take different routes. And as I said, we would support either one of them.

The CHAIRMAN. Mr. Scheppach.

Mr. SCHEPPACH. Yes. The Governors strongly prefer the House bill. We really believe that the Senate bill would be a nightmare in terms of each State has hundreds of pages of tax legislation. And to try to compare that would just be a litigation and a nightmare.

The CHAIRMAN. Mr. Micali.

Mr. MICALI. Mr. Chairman, the Direct Marketing Association prefers the Senate language dealing with the moratorium, viewing it as a more straightforward way to address the issue of Internet taxes.

Senator MOYNIHAN. That solves that. [Laughter.]

The CHAIRMAN. Are you aware of any businesses deciding not to move to the Internet because of either the existence of or the threat of any State or local taxes?

Mr. Duncan.

Mr. DUNCAN. I am not, Mr. Chairman, aware of that circumstance. I am actually aware of the opposite. In an interview with a representative at Amazon.com, he indicated that they chose the location that they did in Washington State. They would have preferred a smaller State, but they chose Washington State for various attributes. And they chose not to go to California or New York because they would be able to market into those two States without the collection of tax by staying solely within the borders of Washington State.

So I think sometimes the tax consequences drive it in the other direction. And I am not aware of any business meeting the circumstances that you outlined.

The CHAIRMAN. Mr. Nebergall.

Mr. NEBERGALL. I understand your question, Mr. Chairman, as to whether I know of any companies that have declined to begin marketing their products online because of the fear of inconsistent State sales tax treatment. I know of no specific company.

However, I am aware of a study conducted by KP&G Peat Marwick that surveyed the attitudes of business executives. And the results of that survey were that companies were afraid to go online because of the fear of multiple and inconsistent tax obligations. And I can provide the committee with a copy of that report.

The CHAIRMAN. Very good.

[The information provided by Mr. Nebergall appears in the appendix, page 108.]

The CHAIRMAN. Mr. Scheppach.

Mr. SCHEPPACH. Well, there is a big advantage actually now of going on the Internet. Governor Rommer of Colorado who also has several businesses that sell tractors went to a tractor conference here several months ago. And he went down to breakfast. And he found that the whole conversation at breakfast was that all these small tractor companies were going onto the Internet because they could avoid the sales taxes. And the sales tax was greater than their profit margins.

And so what you found was this explosion of selling tractors across borders via the Internet. So the tax advantages I think are substantial.

The CHAIRMAN. Mr. Micali.

Mr. MICALI. Mr. Chairman, I am not aware of any specific companies that have deferred a decision due to uncertainty over the Internet. But I would add that the Senate bill would eliminate ambiguity and probably encourage more economic growth on the Internet.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Sir, I think we have had a good morning. I see that a vote has been called. We have had very open testimony about a matter which may involve just another situation where technology changes previous understandings of law. And we can live with that if we recognize it. I think the Quill decision was a due process decision. Mr. Nebergall does not think so.

Mr. NEBERGALL. A commerce clause decision I believe.

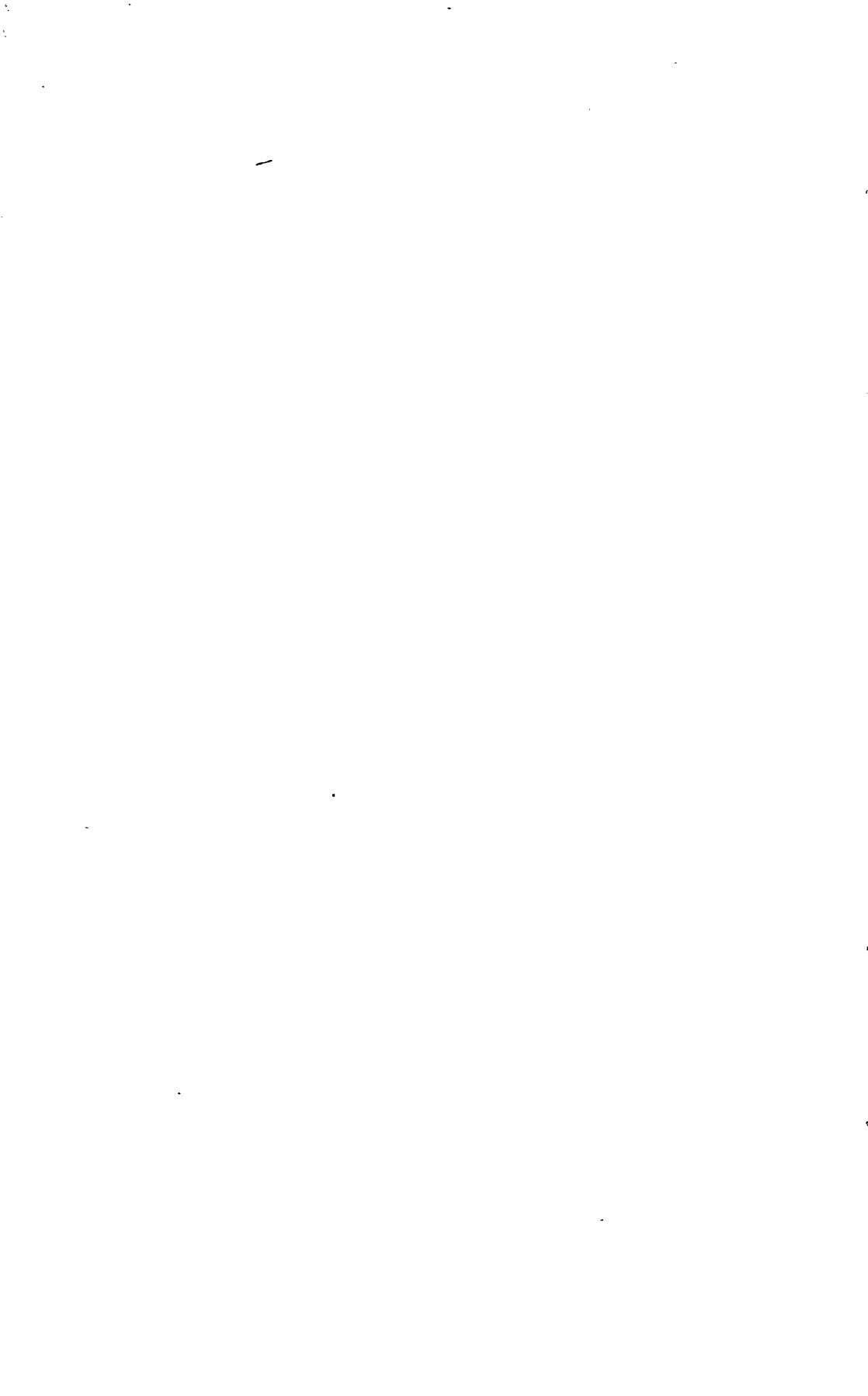
Senator MOYNIHAN. Both a due process and a commerce clause case. And commerce has changed. And let us see if we cannot help people. And we have had at least one witness who said we have nothing against more taxes. I think we should record that. [Laughter.]

But thank you, gentlemen, very much indeed.

The CHAIRMAN. Yes, we appreciate your being here. And undoubtedly, we will have further contact as the legislation proceeds. Thank you very much.

The committee is in recess.

[Whereupon, at 11:47 a.m., the hearing was concluded.]



# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

### PREPARED STATEMENT OF HON. DALE BUMPERS

Mr. Chairman, thank you for providing me the opportunity to testify this morning. I want to call attention to a current problem that will be exacerbated by proposals which would place a moratorium on Internet taxation. Because we allow companies to ship goods across state lines without collecting taxes, consumers are being misled regarding tax liabilities and Main Street businesses are being put at a competitive disadvantage vis-a-vis out-of-state companies.

If Congress passes a moratorium on Internet taxes without resolving this sales tax issue, we will greatly exacerbate this unfair situation as Internet sales explode over the next few years. According to Forrester Research Inc., a Massachusetts consulting firm, the value of goods and services traded over the Internet could grow to over \$300 billion in 2002, a substantial increase from the \$8 billion that electronic commerce is estimated to have generated in 1997. Such an increase will have a devastating effect on main street business and the ability of states to collect revenue, unless we address this inequity now. Proponents of the moratorium on Internet taxes insist that their proposals have nothing to do with sales taxes. However, the broad language used in these proposals may create situations in which states will be unable to charge sales tax to even those companies that have a physical presence in the state. The Congressional Budget Office (CBO) recognize this potential problem when they stated that the moratorium proposed in S. 442 (the Wyden bill) would create an unfunded mandate. CBO expects that litigation will determine which state and local taxes will be preempted under this bill. Clearly, at the very least we need to ensure that states can collect sales tax from merchants who sell over the Internet in their own state.

In addition, Mr. Chairman, Congress should shift the burden of collecting and remitting use taxes (taxes on goods purchased in one jurisdiction for use in another jurisdiction) from the consumer to the company.

In the 45 states which have sales and use taxes, consumers are legally obligated to pay those taxes, regardless whether the purchases are made at a local department store, via mail order, or over the Internet. Unfortunately, catalog companies typically do not make their customers aware of this obligation—in fact, some lead customers to believe that out-of-state purchases are “tax free.” This is patently false. The company may be exempt from collecting use taxes, but the customer remains liable for paying those taxes directly to the state revenue department on every out-of-state purchase.

This situation causes three serious problems. First, thousands of consumers are injured when they learn that their “tax-free” purchase is not really tax free. State revenue departments inform tens of thousands of consumers a year of this sad fact, leaving the consumer liable for back taxes, interest and penalties.

Second, Main Street retailers are placed in an unfair position vis-a-vis mail order houses. This occurs because mail order products appear to cost less than those sold in department stores. In reality, the mail order company is simply neglecting to collect applicable use taxes and allowing consumers to become personally liable for those taxes.

Third, state and local governments lose revenues because some of the taxes are never collected. According to the Advisory Commission on Intergovernmental Relations, state and local governments lose over \$3.3 billion a year for this reason.

The Supreme Court has twice considered the question of whether a state may impose tax collections duties on an out-of-state mail order company. In 1967, the Court ruled in *National Bellas Hess v. Department of Revenue* that such a state action vio-

lated both the Due Process Clause and the Commerce Clause of the United States Constitution. *Bellas Hess* therefore made it impossible for Congress to craft a legislative solution to the problem: although the Commerce Clause is the exclusive domain of Congress, the Due Process Clause is not subject to Congressional discretion. As long as the due process holding from *Bellas Hess* remained good law, Congress' hands were tied.

In 1992, however, the Supreme Court overruled the due process portion of *Bellas Hess*. In *Quill Corporation v. North Dakota*, the Court revisited the issue of mail order tax collection and, applying a more modern due process analysis, concluded that mail order activities now constitute a sufficient connection to the state to justify the tax collection requirement. In other words, a state's imposition of tax collection requirements on an out-of-state mail order company no longer offends due process.

Although *Quill* did not overrule the Commerce Clause portion of *Bellas Hess*, that holding does not preclude Congressional action. Congress may, if it chooses, grant the states the authority to require out-of-state tax collection. Indeed, the Supreme Court expressly acknowledged in *Quill* that "Congress is now free to decide whether, when, and to what extent the states may burden interstate mail-order concerns with a duty to collect use taxes." The same reasoning should apply to goods sold over the Internet.

Earlier this year, I introduced The Consumer and Main Street Protection Act of 1998 (S. 1586) that is designed to remove this unfair advantage enjoyed by out-of-state companies. The legal effect will be to authorize a state or local jurisdiction to require out-of-state companies to collect use taxes on sales of personal property delivered into that state or local jurisdiction.

Mr. Chairman, my proposal does not create a new tax. It merely allows for the fair and equitable collection of existing taxes. If the residents of a state do not wish to pay a use tax, then they can repeal that use tax. That is their prerogative. But if they choose to have a use tax, the federal government should allow them to enforce it. That's what my proposal does—it authorizes the states to collect taxes fairly and evenly from all who conduct business in the state.

My proposal is not a preemption of the states' power to tax. In fact, states are not required to take any action as a result of this bill. They may completely ignore this legislation and continue their present tax collection methods. This amendment merely grants the states a power presently denied under the Commerce Clause and imposes the limitations on that power which are necessary to insure that the resulting burden on out-of-state companies is not unreasonable.

I urge my colleagues on the Finance Committee to carefully consider this issue. It is very important for the continued vitality of Main Street America, and I invite you to join in this effort to ensure fair competition in American business.

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**CHRISTOPHER COX**  
CALIFORNIA

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STEERING COMMITTEE

July 16, 1998

**TESTIMONY OF REP. CHRISTOPHER COX**  
**BEFORE THE SENATE FINANCE COMMITTEE**  
**IN SUPPORT OF THE INTERNET TAX FREEDOM ACT**

Thank you, Chairman Roth and members of the Committee. I am delighted to have the opportunity to speak to you today about the merits of H.R. 4105, the consensus Internet Tax Freedom Act that was approved by the full House of Representatives on June 23 *without a dissenting vote*.

The House's unanimous approval of H.R. 4105 is indicative of more than seven months of direct negotiations with state and local leaders to reach an agreement that balances the national interest in protecting this burgeoning marketplace and the importance of guarding against erosion of the state and local treasuries.

As a result of these negotiations, a number of state and local government organizations joined me at a March 1998 news conference to endorse this revised version of the Internet Tax Freedom Act. The National Governors' Association, National Conference of State Legislatures, National Association of Counties, United States Conference of Mayors, National League of Cities, International City/County Managers Association, and Council on State Governments were among the groups endorsing the revisions. In so doing, these governors, state lawmakers, mayors, and city councilmen joined with President Clinton and with a broad coalition of taxpayer advocates, high-tech companies, and "main street" businesses in supporting the bill.

From the start, this has also been a bi-cameral initiative--and a bi-partisan one. The Senate Internet Tax Freedom Act has a diverse set of cosponsors, including Senators Ron Wyden, John Kerry, Conrad Burns, John McCain, Richard Shelby, Patty Murray, John Ashcroft, Lauch Faircloth, Pat Leahy, Barbara Boxer, and John Warner. Senators Judd Gregg and Joe Lieberman have also been very actively engaged in our effort.

Given the broad consensus that has been built, enactment of the Internet Tax Freedom Act is within our reach, and could well prove to be one of the more notable achievements of the 105<sup>th</sup> Congress. Its enactment will not only give the Internet room and time to grow, but will also serve to protect the Internet against the multiple and discriminatory taxation to which its technology is inherently susceptible.

The House-passed legislation has four main provisions:

- First, it will impose a national time-out on taxes on Internet access, bit taxes, and multiple and discriminatory taxes on electronic commerce.
- Second, it will establish an advisory Commission to study the question of remote sales, and report back to Congress in two years with conclusions and recommendations.
- Third, it will protect Internet services from direct price regulation by the Federal Communications Commission.
- Last, but certainly not least, it will declare that, globally, the Internet should be a tariff-free zone.

I've attached to my written testimony a further explanation of the first three items. In my testimony to you today, however, I'd like to focus in particular on the last item, as it is rightfully a central focus of the Committee's hearing today.

In my view, a disproportionate amount of media attention has been given to the state and local tax provisions of the Internet Tax Freedom Act, which leads many observers to believe that the bill is primarily *inward-looking*, focusing on sub-national but not international obstacles to the commercial development of the Internet. This not only ignores the important language in Section 6 instructing the Clinton Administration to take an aggressive stand internationally to keep foreign taxes and tariffs off electronic commerce; it also fails to appreciate that we are looking to contain, simplify, and provide for more uniform taxes at the state and local level not just as ends in themselves--but also because in so doing we can ensure that the U.S. speaks with a single, strong voice internationally on matters of taxation of e-commerce. If we put in place a policy that within the United States discourages predatory taxation of the Internet, it will be all the easier for the President to demand that foreign nations also keep taxes and tariffs off the 'Net.

Keeping tariffs and special taxes off the Internet is especially important because it will have immediate advantages to the United States, which is well-positioned to dominate the electronic commerce marketplace. U.S. businesses excel in the information and media services that preponderate on the Internet, and even now contribute a net surplus of more than \$20 billion annually to our balance of trade with foreign nations. The continued commercial development of the Internet is expected to provide even greater economic opportunity for U.S. firms.

As we debate this bill, we should not lose sight of its important international and *outward-looking* focus. It is in fact one of the reasons that the Internet Tax Freedom Act is so strongly supported by President Clinton, the U.S. Treasury Department, and our U.S. Trade Representative. And I'm delighted that today's hearing will give additional attention to this important aspect of the legislation.

Finally, I want to take advantage of my appearance here today to propose to you and members of the Committee what I would consider to be a welcome addition to the bill: *adding a federal component to the moratorium on Internet access taxes*. We did not have the opportunity to add such a provision in the House, as the bill was considered in the Judiciary and Commerce Committees but not in the Ways and Means Committee. As a result, the tax moratorium in the House-passed legislation applies to state and local taxes, but does not include a similar federal ban on taxation of Internet access.

In my view, you would be making a significant and substantive improvement to the Internet Tax Freedom Act if you were to add to the moratorium a ban on federal Internet taxes. In addition to a general statement of policy that the Internet should not be taxed at the federal level, the Committee could also specifically legislate that the existing 3% federal excise tax on telecommunications shall not apply to Internet access service. Since such a clarification is consistent with the IRS's current interpretation of the excise tax, there would be no revenue impact. Moreover, the addition of a federal component to the moratorium would be welcomed and actively supported by *both* state and local officials *as well as* by taxpayers and businesses. For all these reasons, I would urge the Committee to give careful consideration to such a proposal.

I'd like to conclude with what I hope will be an instructive anecdote:

*More than a century and a half ago, Michael Faraday invented the dynamo--the first electric motor--by rotating a current-bearing wire around a suspended magnet. He became so well-known for this invention that, one day, he was granted an audience before King William IV. When he described what he had developed, the King looked at him and asked: "But, after all, what use is it?"*

*Faraday came back with a quick response: "Only time will tell, but of this I am certain: Someday, sir, you will tax it."*

Developing new taxes for new technologies need not be an irresistible temptation. The Internet Tax Freedom Act shows that the government can indeed learn the lessons of the past, and that we can protect new technology from the very real dangers of predatory taxation.

Thank you again, Chairman Roth, for giving me the opportunity to testify today.

*Attachments*

# The Internet Tax Freedom Act

## H.R. 4105

*Introduced by Mr. Cox*

*Approved by the House of Representatives on June 23, 1998, by voice vote*

H.R. 4105 represents a merger of two versions of the Internet Tax Freedom Act--the version (H.R. 3849) approved 41-0 by the Commerce Committee on May 14, and the version (H.R. 3529) approved by voice vote by the Judiciary Committee on June 17. Substantively, the bill is supported by the chairmen of both committees, Chairman Henry Hyde and Chairman Tom Bliley. It was approved unanimously by voice vote of the House of Representatives on June 23, 1998.

### ***Background***

The Internet Tax Freedom Act is based on a simple principle: Information should not be taxed. As we enter the digital age, the age of information, establishing this principle in law will have profound and long-lasting consequences. Given the pace of the Internet's growth--the U.S. Commerce Department recently told us that the number of Internet users and the number of web pages are doubling every 100 days--protecting the Internet, and the information and commerce exchanged over the Net, from special and discriminatory taxation on a national basis will prove a further stimulus to the continued technological and commercial development of this dynamic new medium.

The Internet Tax Freedom Act is needed not just to give the Net room and time to grow, but also because the Net is inherently susceptible to multiple and discriminatory taxation in a way that commerce conducted in more traditional ways is not. The very technologies that make the Net so useful and efficient--notably its decentralized, packet-switched architecture--also mean that several States and perhaps dozens of localities could attempt to tax a single Internet transaction. The Internet Tax Freedom Act will protect commerce conducted over the Internet from being singled out and taxed in new and creative ways, and will give Americans the reassurance they need that they will not be hit with unexpected taxes and tax collecting costs from remote governments.

### ***Bill Summary***

The Internet Tax Freedom Act has undergone a number of changes since it was introduced by Rep. Christopher Cox (R-CA) and Sen. Ron Wyden (D-OR) in March 1997. Most of these changes are the result of months of intense negotiations with State and local government leaders. As a result, the legislation has been altered to reflect State and local concerns, and now reflects a balanced compromise between the national interest in protecting this burgeoning marketplace and the importance of guarding against erosion of the State and local treasuries.

In March 1998, Rep. Cox held a news conference to announce the support of the National

Governors' Association, the National Conference of Mayors, the National Conference of State Legislatures, the National Association of Counties, and the National League of Cities for the revised legislation. Numerous changes were made to cause state and local governments to drop their opposition, including: shortening the moratorium from 6 to 3 years; providing for a more targeted moratorium instead of a blanket prohibition on all Internet-related taxes; and creating a temporary commission to study the complex state and local tax issues relating to electronic commerce and propose legislation to Congress.

#### ***Highlights of H.R. 4105***

- **Moratorium on special taxation of the Internet.** Bars, for a 3-year period, "bit taxes" (a tax measured according to every bit of data transmitted over the Net) and taxes on Internet access (i.e. the \$19.95 or so that many Americans pay monthly to America Online, CompuServe, Erol's, or other similar services to access the Internet). Eight states presently taxing Internet access--Connecticut, Wisconsin, Iowa, North Dakota, South Dakota, New Mexico, Tennessee, and Ohio--would be "grandfathered," provided that the state enacts a law within one year expressly affirming that it wants to continue collecting taxes on Internet access. Two states presently taxing Internet access--Texas and South Carolina--opted not to have their tax laws included in the "grandfather."
- **Moratorium on multiple and discriminatory taxes on electronic commerce.** Bars, for a 3-year period, taxes that would subject buyers and sellers of electronic commerce to taxation in multiple states. Also protects, for a 3-year period, against the imposition of new tax liability for consumers and vendors involved in commercial transactions over the Internet. This includes the application of discriminatory tax collection requirements imposed on out-of-state businesses through strained interpretations of 'nexus.' It would also protect from taxation, for the duration of the moratorium, goods or services that are sold exclusively over the Internet with no comparable off-line equivalent.
- **Establish commission to study question of remote sales.** A temporary Advisory Commission on Electronic Commerce will study electronic commerce tax issues and report back to Congress after two years on whether electronic commerce should be taxed, and if so, how they can be taxed in a manner that ensures such commerce won't be subject to special, multiple, or discriminatory taxes. State and local elected officials will be given a prominent voice on this commission. Congress is encouraged to carefully consider the Commission's legislative recommendations, but committees retain full authority to change or discard the Commission's proposals.
- **Protects Internet services from F.C.C. regulation.** Clarifies 1934 Communications Act that the Federal Communications Commission cannot impose price regulation on the charges paid by subscribers for Internet access and online services. Likewise, the FCC is not permitted to collect regulatory fees from providers of Internet access or online services.

- Declares that the Internet should be tariff-free zone. Calls on the Clinton Administration to work aggressively through the EU and WTO to keep electronic commerce free from tariffs and discriminatory taxes. Asks Commerce Department to report to Congress on barriers hindering the competitiveness of U.S. businesses engaged in electronic commerce abroad.

#### *House Committee Action*

Rep. Cox introduced H.R. 1054, the Internet Tax Freedom Act in March 1997. It was referred to two main committees, the Commerce Committee and the Judiciary Committee. Hearings were held in both committees in July 1997. In October 1997, the Commerce Subcommittee on Telecommunications and the Judiciary Subcommittee on Commercial and Administrative Law each approved amended versions of the legislation.

Subsequent to these markups, Rep. Cox negotiated an agreement with state and local leaders. A new bill (H.R. 3849) was introduced in May 1998 reflecting this agreement. It was approved by the full Commerce Committee on May 14, 1998, by a 41-0 vote. The committee filed House Report 105-570, Part 1. The full Judiciary Committee reported out virtually identical legislation (H.R. 3529, introduced by Rep. Steve Chabot) on June 17, 1998, by voice vote. The main difference between the two bills was that, on the latter bill, Judiciary was the primary committee of jurisdiction, whereas the Commerce Committee was the primary committee on H.R. 3849.

To merge these two separate bills into one, Rep. Cox introduced a new version, H.R. 4105, that takes the key provisions from each bill. Sections 2 and 7--the state and local tax provisions--are taken from the Judiciary Committee's bill. Sections 3-6 and 8--which includes important FCC language--are taken from the Commerce Committee's version of the bill.

#### *Administration Support*

In February 1998, President Bill Clinton specifically endorsed the Internet Tax Freedom Act in a speech to high-tech executives. Previously, in May 1997, Deputy Treasury Secretary Larry Summers testified before the Senate Subcommittee on Communications in support of the legislation.

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## PREPARED STATEMENT OF HON. ALFONSE D'AMATO

Mr. Chairman, I commend you for your leadership in once again safeguarding the authority of the Finance Committee on issues that are clearly within its jurisdiction.

The Internet's explosive growth in recent years is testimony that the 1990's is turning into the Internet Era. The number of Americans using the Internet has nearly doubled—to about 40 million adults—over the past year. Host computers permanently connected to the network rose to 26 million in 1997, and it continues to climb. Businesses are moving quickly to get their products onto the worldwide web, and today you can buy almost anything online.

Even Congress is rapidly moving to the web. In 1995 only 10 Senators and four House members had home pages. Today, almost every Member of Congress has information on the web.

The range of goods and services available through the Internet include booking hotel and travel reservations, conducting financial transactions, and viewing and ordering merchandise from shopping catalogs, to name a few. While the Internet offers almost limitless possibilities for the free communication of ideas, research, and information, serious concerns have been raised by businesses and consumers alike about State and local taxation of the Internet.

It is estimated that the Internet will generate billions of dollars in sales over the coming years. That prospect brings about the reality that state and local governments will see an unlimited revenue source and begin to assess *new* Internet taxes. This would be unfair to the American consumer and devastating to small businesses who could be stifled by complicated taxation and regulation of the Internet. In addition, it could hurt the development of electronic commerce in the United States.

Mr. Chairman, the House and Senate bills include provisions to protect both consumers and electronic commerce from added taxation by state and local governments. This is important because now is not the time to be increasing taxes on the American people. However, we must carefully craft legislation so as not to disrupt the collection of state and local taxes that were legitimately imposed prior to the enactment of any Federal legislation.

I strongly support a moratorium on future taxation of Internet access and electronic commerce, and the establishment of a Commission to examine methods for administering and collecting sales and use taxes on interstate commerce. This is necessary to prevent the possible destruction of a still-developing technology.

I look forward to hearing the views of today's witnesses.

## PREPARED STATEMENT OF HARLEY T. DUNCAN

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before you this morning on S. 442 and H.R. 4105, two different versions of a measure entitled the "Internet Tax Freedom Act." My name is Harley Duncan, and I am the Executive Director of the Federation of Tax Administrators. The Federation is a membership organization dedicated to improving the techniques and standards of state tax administration. It represents the interests of the principal tax administration agencies in the fifty states, the District of Columbia, and New York City.

## BACKGROUND

S. 442 and H.R. 4105 would both establish limits on the ability of state and local governments to impose taxes on charges for Internet access and certain forms of electronic commerce as well as establishing a commission to study state and local taxation of electronic commerce and to make recommendations thereon to the Congress. The policy of the Federation regarding these issues was established in resolutions adopted by the membership at its 1997 and 1998 Annual Meetings. [Copies of those resolutions are attached.] The summary position of the Federation is that if the Committee feels legislation of this sort is warranted, we would urge the Committee to adopt the basic approach and general features contained in H.R. 4105 with several modifications as opposed to the approach contained in S. 442. Our reasons for this and the suggested modifications are discussed below.

## GENERAL PRINCIPLES

The policy statements adopted by the Federation established several general principles that it believes should govern any legislation adopted by the Congress to govern state and local taxation of the Internet and electronic commerce.

1. *Any legislation passed by the Congress should be prospective only and should not preempt taxes that are currently imposed by state and local governments on var-*

*ious aspects of electronic commerce.* The U.S. Constitution provides appropriate limitations on the types of taxes which state and local governments may impose as well as the taxpayers and activities which they may tax. Only in the most compelling of circumstances, which we do not believe have been shown here, should the Congress intervene to preempt current taxes which have been legitimately imposed by states and localities on activities occurring within their boundaries.

The primary current tax at issue in this legislation is the imposition of state and local sales and use taxes on charges for Internet access and online services. At this time, 11 states, the District of Columbia, and 12 home rule cities in Colorado impose their sales and use tax or another tax on Internet access and online service charges.[1] We see no reason why these taxes should in any way be disrupted or preempted. They are applied to an essentially local activity, i.e., the connection between a consumer and an Internet service provider (ISP); they have been adopted and imposed under procedures prescribed in each state; and any taxpayer who feels aggrieved by the tax and its administration have adequate avenues of appeal in each of these states.

S. 442 as reported by the Senate Commerce Committee would preempt state and local taxes currently imposed on Internet access and online service charges. H.R. 4105 would "grandfather" or continue in existence the tax on Internet access charges in 8 states named in the bill, but would require that these states re-enact the tax within one year to continue it in effect. Given this preservation of current taxes, H.R. 4105 is to be preferred, but we believe there should be modifications to that measure as discussed below.

2. *Any legislation should not affect tax liabilities (and resulting penalties and interest) arising under state and local tax laws that were appropriately imposed prior to the date of enactment of any federal legislation.* As a corollary to the first principle, Congress must take care in crafting legislation which imposes constraints on current and future state and local tax authority not to disrupt or otherwise affect liabilities which have arisen or accrued under taxes that were legitimately imposed prior to the enactment of any federal legislation. Certain versions of the Internet Tax Freedom Act would effectively absolve Internet service providers who have not complied with current state and local taxes on Internet access charges from any liability under those taxes by preventing states and localities from "assessing, collecting or attempting to assess or collect" any tax after the enactment of the federal legislation.

We believe that S. 442 as approved by the Senate Commerce Committee could be interpreted to have this effect. That is to say, if an Internet service provider had not complied with state law governing the taxation of its access charges, enactment of the bill as reported could be interpreted to prevent the state from auditing, assessing and trying to collect tax for the period of time in which the tax was lawfully in effect. This is obviously an unfair situation for those ISPs who have faithfully complied with state law.

According to House Judiciary Committee staff, H.R. 4105 as passed by the House is not intended to affect prior tax liabilities. We agree with this approach, but believe a technical amendment (see below) will clarify this intent.

3. *Any legislation which imposes limits on state and local tax authority should address specifically the types of taxes which are intended to be prohibited or circumscribed, rather than imposing a broad prohibition on state and local taxation and then allowing certain exceptions to the prohibition.* One of the primary differences between S. 442 and H.R. 4105 is in the general approach they take in circumscribing state and local tax authority. S. 442 imposes a broad prohibition on taxation of "Internet communications and transactions" and then imposes standards on the types and nature of taxes which are considered allowable. H.R. 4105, on the other hand, specifically prohibits certain taxes on Internet access charges as well as defining clearly prohibited "multiple" and "discriminatory" taxes, but does not otherwise interfere with lawful state and local taxes on electronic commerce.

The approach taken in H.R. 4105 is strongly preferred by state and local governments because it provides a clearer delineation of the limits imposed on them. The approach taken in S. 442 causes the ambiguities and risks created by any lack of clarity in the bill to be shifted to state and local governments. That is, they will have to show that the tax they employ falls within the "four corners" of the stated exception, rather than showing they are not violating a stated proscription as is the case in H.R. 4105 and would be the norm in statutes of this sort.

4. *Any legislation should not disrupt current law and standards regarding the obligation of remote sellers to collect states and local sales and use taxes in a way which either favors or disfavors vendors in electronic commerce compared to other forms of commerce.* We believe that passage of an Internet tax measure should not create a preferred position for electronic commerce vis-a-vis other forms of commerce



whether they be Main Street retailers or direct marketers. S. 442 falls short of this goal by effectively classifying electronic commerce as "mail order sales" regardless of the nature of the contacts a seller may have with a state. H.R. 4105, on the other hand, maintains substantial parity between all forms of commerce by providing that in determining whether a tax may be applied to electronic commerce that the appropriate comparison is to the item being sold, not the means through which the transaction is carried out.

5. *Any legislation should provide a mechanism which will require the U.S. Congress to examine seriously the endorsement of a sales and use tax administration system in which all sellers above a certain sales threshold would be required to collect state sales and use taxes on all taxable items sold in conjunction with a substantially simpler and more uniform state and local sales and use tax. It should also support the efforts of the National Tax Association Communications and Electronic Commerce Tax Project to examine the application of state and local taxes to electronic commerce and to simplify the sales tax administration system.*

Clearly the major issue posed by electronic commerce for state and local governments is not the taxation of Internet access, but is instead the potential for serious erosion of the state and local sales tax base due to the rapid expansion of remote commerce conducted over the Internet and online services. Currently, a state may not require a seller to collect sales and use taxes on goods sold into the state unless the seller has a physical presence in the state, although the Supreme Court has clearly said that Congress has the authority under the Commerce Clause to alter that requirement.<sup>[2]</sup> The tax on such sales is still due and owing, but it must be collected directly from the consumer which is, of course, problematic, difficult, and severely intrusive. As a result, an extremely small proportion of state use taxes on remote sales to individual consumers is actually collected.<sup>[3]</sup> The Internet vastly increases the opportunities for sellers to engage in remote commerce and for consumers to purchase from remote sellers. The potential danger for the sales tax base is clear.

State and local governments believe that the long-term viability of the sales tax requires a system in which all sellers above a certain sales threshold are required to collect state sales and use taxes on all taxable items sold into a state, regardless of whether they have a physical presence in the state. Likewise, we recognize that state and local sales tax laws and administrative systems must be substantially simpler and more uniform before such a collection requirement can realistically be imposed and will be seriously considered by the Congress. States and localities believe the Internet Tax Freedom Act should be used as a vehicle to put in motion an examination of a simpler, more uniform, more evenly applied sales tax system that will be required in this country in the 21st Century.

State and local governments, through the National Tax Association Communications and Electronic Commerce Tax Project, are working with representatives of the communications and electronic commerce industries to examine the issues involved in the application of sales and use taxes to electronic commerce and to examine the types of simplifications which can be achieved in the sales tax administration system. We believe the Internet Tax Freedom Act should support this process by creating an executive-level government/industry group to review the work of the NTA Project as well as other issues and to make recommendations to the Congress which will facilitate a debate of an extension of the requirement to collect state and local sales taxes under a substantially simplified and more uniform sales tax system.

H.R. 4105, with modifications discussed below, we believe is superior to S. 442 in its study of future state and local tax policies. H.R. 4105 calls for a government industry group to conduct the study (as opposed to an inquiry conducted primarily by Federal officials as in S. 442) and the study in H.R. 4105 applies to all forms of remote commerce and all aspects of sales tax administration (as opposed to being focused narrowly on certain electronic commerce issues.)

#### RECOMMENDED MODIFICATIONS TO H.R. 4105

The Federation would recommend that in its deliberations that the Committee consider several changes to H.R. 4105 as passed by the House of Representatives. Those changes are as follows:

**Grandfather Clause.** H.R. 4105 provides that current taxes on Internet access charges in eight named states will continue in force only if those state re-enact the taxes to impose them specifically on Internet access within a one-year period. We believe this is an unnecessary and inappropriate requirement and is insufficiently protective. First, it specifically excludes taxes on Internet access that are imposed in the District of Columbia as well as certain local governments in Colorado. Second, as noted above, the taxes currently imposed are

fully legitimate and lawful, and there has been no showing of any inordinate burden imposed as a result of them. Any taxpayer which feels aggrieved by the tax can protest its imposition through all available legal means. To require that the tax be re-enacted by a state seems designed to give a certain segment of the industry a "second bite of the apple" and not to foster any sound public policy purpose.

The Federation recommends that H.R. 4105 be amended to provide that the prohibition on taxation of Internet access charges not be applied to any tax on such services that is lawfully in effect on the date of enactment of the federal legislation and that such a prohibition be prospective only.[4]

**Back Tax Liability.** As noted above, we believe in good faith that it was the intent of the House Judiciary Committee and other principal House sponsors that H.R. 4105 would have no effect on any tax liabilities which arose or were accrued under taxes in effect prior to enactment of the federal legislation. Nonetheless, H.R. 4105 could be interpreted to prevent states from enforcing such taxes for prior periods if the tax is not re-enacted by the state or if it is not named in the bill. We do not believe this was intended by the House and believe the concern could be clarified by providing that the moratorium on taxation of Internet access charges in §151(a) of H.R. 4105 be limited to Internet access "services delivered on or after the date of enactment" of the federal legislation. Addition of the language in quotations will clarify that the bill is prospective only in its application.

**Membership of the Advisory Commission on Electronic Commerce.** As noted, states and localities believe that the part of H.R. 4105 which is greatest long-term importance is the examination of simplification and greater uniformity in state sales taxes in exchange for an expansion of the duty to collect such taxes by remote sellers. This study must necessarily examine all forms of commerce and retailing, and accordingly should have representation from all forms of retailing. In H.R. 4105, traditional store-based retailers are not represented on the Advisory Commission, and we would recommend that the make-up of the business representatives to the Commission be modified to insure that it includes at least two representatives of Main Street or traditional, store-based retailing. In addition, the state and local government organizations named in the bill will be represented on the Commission by elected officials. We believe that the business representatives on the Commission should likewise by executive officials in the organizations they represent, and not merely "employed by or affiliated with" such interests. The Advisory Commission created by the bill needs to be executive and managerial level officials that by nature of their positions take a broad view of issues and have authority to make decisions. Technical staff input can be obtained through the National Tax Association and other means.

**Multiple Taxes.** A technical correction needs to be made to the definition of "multiple tax" in §155(8) of H.R. 4105. The phrase "pursuant to a law referred to in section 151(b)(1)" should be deleted. The effect of this phrase is to limit the exclusion of state and piggy-back local sales taxes from the definition of multiple taxes to just the 10 states listed in section 151 and within those states to just the taxation of "Internet access." The definition of "multiple tax" (and the prohibition thereon) applies to all forms of electronic commerce and all states. There are about 30 states in which there is a state sales tax and a piggy-back local sales tax for cities and/or counties. All this parenthetical in which the problematic phrase occurs is doing is saying that a situation in which a state, city and/or county sales tax is levied on electronic commerce is not a multiple tax. If the phrase remains, the sales tax system as employed in a number of states would be subject to attack as a "multiple tax" when applied to electronic commerce.

#### CONCLUSION

For the reasons noted above, the Federation believes that H.R. 4105 is a superior vehicle if the Committee believes that restrictions should be imposed on states and localities regarding the taxation of electronic commerce, and that with the modifications cited above, it will provide for an appropriate balancing of the aims and concerns of both states and localities as well as the electronic commerce and online industries. This is not surprising given that H.R. 4105 is the result of substantial discussions and negotiations between representatives of state and local government and representatives of the online and electronic commerce industries. It is also benefited greatly from substantial interaction among the staff of the relevant committees

in the House of Representatives, state and local governments and representatives of the affected business groups.

This give and take process, which has not occurred on the Senate side, has produced a measure which I believe has substantial acceptance by states and localities as well as the online industry. It has also produced a product which represents substantial compromise on both the government side as well as the industry side. We hope that you and your staff will take the additional time that is required to address a relatively few outstanding points and to improve this important measure.

#### ENDNOTES

[1] Those states are Connecticut, Iowa, New Mexico, Ohio, South Carolina, South Dakota, Tennessee, Texas, West Virginia, Wisconsin, North Dakota and the District of Columbia.

[2] See *Quill Corp. v. North Dakota* 504 U.S. 298 (1992).

[3] Estimates are that the amount of revenue lost by state and local governments due to such sales exceeds \$3.5 billion annually.

[4] Should the Committee desire to retain the approach of specifically naming states in the legislation, there are two additional states which should be added to the list and certain statutory references in the bill need to be corrected.

### Resolution Nineteen

#### Federal Legislation on Electronic Commerce

**WHEREAS**, the Internet and other on-line electronic commerce services form a global network that operates independently of local, state and federal boundaries, and

**WHEREAS**, there is potential for electronic commerce conducted via the Internet and other on-line services to grow dramatically, and

**WHEREAS**, state and local tax laws and rules in place for traditional commerce are not well-suited to electronic commerce, and

**WHEREAS**, effective application of state and local taxes in an electronic commerce environment inherently requires cooperative activities among the states and with participants in the electronic commerce business, and

**WHEREAS**, the National Tax Association has assisted in the formation of a working group of industry, legal, and state and local government authorities, known as the NTA Communications and Electronic Commerce Tax Project, to examine the issues involved in the application of state and local taxes to electronic commerce and to develop recommendations, including model legislation, to address those issues, and

**WHEREAS**, the U.S. Congress is now considering the "Internet Tax Freedom Act of 1997" which is intended to impose a indefinite moratorium on the imposition of certain state and local taxes on electronic commerce, and

**WHEREAS**, the impact of certain versions of this legislation are substantially broader than the stated purpose and certain versions the potential to substantially disrupt state and local tax systems, now, therefore, be it

**Resolved**, that the Federation of Tax Administrators believes that any federal legislation affecting state and local taxation of electronic commerce, if such is to be enacted, should meet the following criteria:

(a) Such legislation should not affect tax liabilities (and resulting penalties and interest) arising under state and local tax laws that were appropriately imposed prior to the date of enactment of any federal legislation;

(b) Such legislation should not preempt state and local governments that are currently imposing taxes on various aspects of electronic commerce;

(c) Such legislation should not disrupt current law and standards regarding the obligation of remote sellers to collect states and local sales and use taxes in a way which either favors or disfavors vendors in electronic commerce compared to other forms of commerce;

(d) Such legislation should support the goals and operations of the National Tax Association Communications and Electronic Commerce Tax Project in its efforts to assess the impact of electronic commerce on state and local taxation and to bring simplification and uniformity to the state and local sales tax administration system;

(e) Such legislation should provide a mechanism which will require the U.S. Congress to examine seriously the endorsement of a sales and use tax administration system in which all sellers above a certain sales threshold would be required to collect state sales and use taxes on all taxable items sold in conjunc-

tion with a substantially simpler and more uniform state and local sales and use tax, and be it further

**T3Resolved**, that the Federation of Tax Administrators shall work with other interested organizations in the development, drafting and analysis of legislation meeting these standards.

[PASSED BY UNANIMOUS CONSENT, JUNE 1998]

**Resolution Twenty  
Electronic Commerce**

**WHEREAS**, the Internet and other on-line electronic commerce services form a global network that operates independently of local, state and federal boundaries, and

**WHEREAS**, there is potential for electronic commerce conducted via the Internet and other on-line services to grow dramatically, and

**WHEREAS**, state and local tax laws and rules in place for traditional commerce are not well-suited to electronic commerce, and

**WHEREAS**, effective application of state and local taxes in an electronic commerce environment inherently requires cooperative activities among the states and with participants in the electronic commerce business, and

**WHEREAS**, the National Tax Association has assisted in the formation of a working group of industry, legal, and state and local government authorities, known as the NTA Communications and Electronic Commerce Tax Project, to examine the issues involved in the application of state and local taxes to electronic commerce and to develop recommendations, including model legislation, to address those issues, and

**WHEREAS**, the U.S. Congress is now considering the "Internet Tax Freedom Act of 1997" which is intended to impose an indefinite moratorium on the imposition of state and local taxes on electronic commerce, and

**WHEREAS**, the impact of this measure as now written is far broader than its stated purpose and holds the potential to substantially disrupt state and local sales and property taxes currently applied to electronic transactions, now, therefore, be it

*Resolved*, that the Federation of Tax Administrators opposes the Internet Tax Freedom Act as it is currently written, and be it further

*Resolved*, that the Federation of Tax Administrators believes the appropriate forum for achieving uniform rules for the application of state and local taxes to electronic commerce is the NTA Communications and Electronic Commerce Tax Project, and be it further

*Resolved*, that the Federation of Tax Administrators encourages states, industry representatives and others involved parties to support the efforts and the work of the NTA Communications and Electronic Commerce Tax Project, and be it further

*Resolved*, that the Federation of Tax Administrators shall work with other interested organizations to amend the Internet Tax Freedom Act to avoid unintended impacts.

[PASSED BY UNANIMOUS CONSENT, JUNE 1997]

## TESTIMONY OF SENATOR JUDD GREGG

*Internet Trade and Taxation*Committee on Finance  
July 16, 1998

Mr. Chairman, Senator Moynihan, and other Members of the Committee, thank you for the opportunity to testify before you today.

While the Internet tax moratorium issue has not been the most public or controversial item moving through Congress this session, I believe that it could very well be one of the most important -- especially if it is crafted improperly. I will only briefly touch upon the explosive growth of the Internet and the need for a moratorium, which others today will surely discuss at length. Rather, I will focus my remarks primarily on two other vitally important issues -- first, the need to keep the proposed legislation from leading to a massive tax increase on the American people and, second, the international trade implications of going down that road.

Last March, Senator Lieberman and I introduced S. 1888, the Internet Fairness and Interstate Responsibility Act, because we believe it is critical that Congress take action on this issue. Internet tax proponents say that a moratorium is a solution in search of a problem, but that position is short-sighted and ignores the international dimension of the issue.

The basic reason we need a moratorium is one of economic stewardship. Just four or five years ago, the vast majority of Americans had never even heard of the Internet. This year an estimated 16 million online shoppers will conduct transactions totaling over \$6 billion. By the year 2000, an estimated 33 million consumers will spend close to \$20 billion online, and business-to-business transactions will reach \$175 billion. These estimates indicate the vast potential the Internet holds as a significant engine of continued economic prosperity for this country. Thus, it is our responsibility to act before a hodge-podge of state and local taxes are imposed, creating a serious drag on the Internet's development.

As this issue has moved through Congress, the legislation has come down to two basic sections -- how to impose the moratorium itself and how to create a formalized commission that operates during the moratorium period. Each has its own set of sub-issues and controversies, but I want to focus on the commission. In my view, the commission constitutes the bill's most important battleground, because mistakes in this area could be very grave and long-lasting.

By way of background, in 1967, the Supreme Court ruled in the Bellas Hess case that a state did not have the constitutional authority to force a business that was not located in the state, and that did not have substantial connections or nexus to the state, to collect its sales tax on a sale made through mail order or telephone to one of its citizens. This ruling was affirmed in 1992 in the Quill decision. The Court based its decision on the Commerce Clause of the Constitution, which protects the nation's economy from the states imposing undue burdens on interstate commerce. As a former governor, I can tell you these decisions have long been thorns in the side of the National Governors Association (NGA).

Once the Internet tax moratorium issue gained some attention, the major state and local government organizations acted to turn it into a vehicle to overturn Bellas Hess and Quill. They sought the creation of a commission chartered with drafting federal legislation to give them the ability to expand their tax collection authority over interstate mail order, telemarketing and other remote sales. They also sought fast-track Congressional consideration procedures for the commission's bill. Make no mistake about it, these groups don't just have their eyes on taxing Internet commerce, but on the much larger world of mail order and telemarketing sales as well.

In other words, the commission has become a major tax battleground, with the potential to lead toward a major tax increase on the American people. Unfortunately, the House bill adopted much of this pro-tax agenda in its commission mandates. I do not believe a commission should be granted this type of authority. A bill designed to lift tax burdens off the Internet should not effectively sanction a significant, and regressive, across the board tax hike. Any commission should be similar to what Senator Lieberman and I proposed, focusing on issues solely related to the Internet, and how to help it grow.

This is important not just as a matter of tax policy, but of trade policy as well. As this committee already recognizes, the Internet tax issue has serious trade implications. On this point, this Administration deserves a lot of credit for fighting the European Unions' and other nations' efforts to impose their own tariffs and discriminatory taxes on Internet transactions. We recently obtained an agreement from the 132 member World Trade Organization for a moratorium, that will for the time being maintain the Internet as a world wide duty-free zone. But that is a very precarious position.

The Administration's efforts would be irreparably undermined if the United States allowed its states to impose taxes on Internet transactions. One of the most high-tech states in the nation, California, alone conducts more international trade than most countries, so what occurs in the states does affect our federal trade positions. If we cannot control our taxing impulses domestically, we have no standing to ask other nations to control their own. Moreover, foreign Internet tariffs will be based not just on the desire of foreign governments to obtain new revenue, but also on protectionist desires to level the significant advantages that the United States enjoys in information technology and other areas very suitable to Internet commerce. Even creating a commission along the lines as proposed by the House, without regard to what that commission may ultimately decide, would send a terrible signal to the world that we are considering someday allowing our states to tax remote sales, including those conducted over the Internet.

In short, a strong moratorium and focused commission would buttress our trade policy. A poorly designed moratorium bill and commission would significantly undermine our trade policy in an area where our businesses generally enjoy a large competitive advantage.

In closing, I would urge this Committee to look at this issue carefully. It involves international trade policy, the potential for a massive tax increase on the American people, and how best to nurture a most promising engine of continued economic prosperity for this nation.

The Internet is very much an American invention, and also a quintessentially American undertaking. Its explosive growth is based on freedom, individuality and rewarding ingenuity. It is very appropriate that America would take the lead in not only developing the Internet, but also keeping it a tax and tariff-free zone. We do not know whether the Internet will become as profound an economic force as the Industrial Revolution, as some analysts have claimed. But we owe it to our country, and the world, to show some wisdom as we strive to nurture its potential.

## PREPARED STATEMENT OF JOSEPH H. GUTTENTAG

Mr. Chairman and Members of the Committee:

I am pleased today to have this opportunity to present the views of the Treasury Department on taxation of the Internet, including proposed legislation dealing with state and local tax issues and, more broadly, international tax concerns. The state and local tax issues are dealt with in the Internet Tax Freedom Act (S. 442 and H.R. 4105). When I advised Deputy Secretary Lawrence Summers of this important hearing he asked me to convey his continued strong support for the Internet Tax Freedom Act. The Internet Tax Freedom Act has undergone some very important revisions since Deputy Secretary Summers testified in favor of its goals and principles last year. These revisions have addressed some technical and substantive concerns that we have had in the past and now put the Administration in a position to support strongly this legislation. In February, the President announced his support for legislation. More recently, last month, Deputy Secretary Summers wrote to the Speaker of the House and Ranking Minority Member to convey the Administration's support for the legislation and its important goals on the eve of passage of H.R. 4105 by the House.

The Internet Tax Freedom Act as passed by the House would impose a three-year moratorium on subnational taxation of the Internet, including taxes on Internet access and bit taxes, and would prohibit multiple and discriminatory taxes on electronic commerce. The moratorium would not apply to Internet access taxes imposed by certain states if certain conditions are met. The bill establishes an Advisory Commission on Electronic Commerce that will address issues concerning the taxation of all remote sales. The Commission, consisting of the Secretaries of the Treasury and Commerce and the Attorney General, or their representatives, business, taxpayer, and subnational government representatives, in consultation with the National Tax Association—Communications and Electronic Commerce Tax Project, would undertake a broad and thorough study of numerous issues concerning domestic and international taxation of the Internet and electronic commerce.

The legislation to which I refer does not, of course, involve Federal level taxation. However, the broad tax and trade implications of the Internet and related new technologies make it imperative that we develop an appropriate legislative background that will encourage the growth of these wonderful new tools consistent with sound fiscal policy and the many other issues involved.

Treasury believes that two vital goals are addressed by this legislation. First, we would not want duplicative, discriminatory or inappropriate taxation by thousands of different state and local tax jurisdictions to stunt the development of what President Clinton has called "the most promising new economic opportunity in decades." For this reason, we support a temporary and appropriate moratorium on taxation of the Internet. Second, to insure that the Internet does not become a tax haven that drains the sales tax and other revenues that our states and cities need to educate our children and keep our streets safe, in conjunction with this moratorium, we need to establish a commission to explore the longer-term tax issues raised by the Internet and electronic commerce.

As the legislation has moved forward, Treasury has worked closely with many interested constituencies, including state and local governments and their representatives and the affected industries, to reach the point where we have arrived today. We will continue to keep in contact with these constituencies.

Mr. Chairman, we will continue working with the Members and staff with respect to issues with which we might be helpful. We hope that the remaining issues can be resolved promptly between the two Houses with the assistance of state and local tax authorities and the affected industries.

The proposed legislation declares that it is the sense of the Congress that the President should seek bilateral and multinational agreements to establish that the provision of Internet access or online services be free from international tariffs and discriminatory taxation. Going forward, the Treasury Department is particularly well-positioned to assist with the international tax implications of the Internet and electronic commerce.

My testimony will focus on the international efforts underway to create a smooth playing field for commercial activity on the Internet. Our tax policy in this area, as reflected in support of the proposed Internet Tax Freedom Act, is consistent with our overall international tax policy towards the Internet, electronic commerce, and all of the related new technologies.

## OVERALL TAX POLICY

To encourage the growth of this technology and the resulting social and economic benefits, it is crucial that governments act responsibly and fairly regarding the

Internet and electronic commerce. The Administration's key objectives are no new Internet taxes and neutrality in taxing electronic commerce. Overall, it is the view of the Administration that there should be no tax rules at the national, international, federal or sub-federal levels that inappropriately impede the full development of these exciting new technologies.

Neutrality is a fundamental principle that should guide the development of tax rules in this area. Neutrality requires that the tax system treat economically similar transactions equally, whether such transactions occur through electronic means or through conventional channels of commerce. In addition, tax rules should be consistent across jurisdictions, so as to minimize the possibility of multiple or no taxation, and the rules should be transparent and easy to administer, so as to protect the revenue base.

#### INTERNATIONAL ISSUES

Close cooperation and mutual assistance are necessary between the United States and all of our trading partners to ensure that international policies regarding the Internet and electronic commerce are consistent and do not lead to multiple or discriminatory taxation of electronic commerce or the Internet. Continuing these efforts is one of our major objectives.

Treasury has been a leader in adapting international tax rules to electronic commerce. In November 1996, Treasury published *Selected Tax Policy Implications of Global Electronic Commerce*, an issues paper that set forth both the major international tax issues created by electronic commerce and the general tax policy principles that should apply in this area. This paper has been very well-received and has been widely read, both in the United States and abroad. This paper has helped us formulate specific tax policy guidance and has stimulated other countries to prepare their own papers. At least half a dozen other countries have issued similar papers addressing various aspects of global electronic commerce.

Treasury is actively involved in the work of the Organization for Economic Cooperation and Development, which is at the forefront in developing international tax rules to achieve our mutually desired objectives. Many of our efforts are directed at preparing materials for the upcoming OECD Ministerial conference on "A Borderless World: Realising the Potential of Global Electronic Commerce." This conference, which will be held in Ottawa in October, will provide an international platform to present, along with other important issues, basic framework conditions regarding the taxation of electronic commerce. These framework conditions make it clear that any taxation of the Internet or electronic commerce should be neutral, fair, simple, consistent, effective and flexible.

These concepts will be discussed fully with business at the tax roundtable the day immediately preceding the Ministerial conference. At the tax roundtable, governments and business will have the opportunity to explore the challenges and opportunities presented by the Internet. One of the main topics of discussion will be identifying the best mechanisms for modernizing tax rules and collection procedures to accommodate global electronic commerce. The conference will offer an opportunity for all interested parties from all over the world to share knowledge and resolve issues.

The examination of issues concerning electronic commerce is not limited to the United States. The European Commission issued in April 1997 a Communication entitled *A European Initiative in Electronic Commerce* that promoted the elimination of barriers to the development of the Internet. Several countries, including Japan and France, as well as the European Union, have issued joint statements with the United States on the Internet and electronic commerce. Additional statements with other major trading and investment partners are in the works.

In addition to Treasury's specific efforts to ensure that inappropriate taxation on any level does not impede the development of the Internet, the Administration as a whole is committed to encouraging the growth of electronic commerce. An inter-agency working group has developed a set of principles to guide government's role in promoting electronic commerce. These principles deal with financial issues, such as customs, taxation, and electronic payments; legal issues, such as intellectual property protection, privacy, and security; and market access issues, such as telecommunications infrastructure and information technology, content regulation, and technical standards. These principles were set forth in *A Framework For Global Electronic Commerce* on July 1, 1997, a report that will be updated shortly.

Although government has an important role to play, we recognize that the private sector must lead this growth and that the success of electronic commerce requires a continuation of the partnership between the private and public sectors. Furthermore, as stated in the *Framework for Global Electronic Commerce*, "Innovation, ex-



pansion of services and participants, and lower prices will depend upon the Internet remaining a market-driven arena, not one that operates as a regulated industry." Government's role should be limited to extending appropriate regulatory policies to the Internet and electronic commerce. For example, businesses need to know that contracts entered into on-line are valid, consumers need to know that goods and services purchased on-line are subject to consumer protection laws, and government needs to know that the Internet is not being used for any illegal activity. These objectives must be accomplished while recognizing the unique features and potential of the Internet and electronic commerce.

The Administration is working on several fronts to achieve these goals. The Office of the United States Trade Representative has advocated in international fora, such as the World Trade Organization, the OECD, and APEC, that cyberspace remain a tariff-free environment whenever it is used to deliver products or services. Our overall objective is to keep the Internet free from international tariffs and discriminatory taxation.

#### SUBNATIONAL ISSUES

The field of taxation is one of the most important areas where governments must adopt appropriate rules. Unreasonable taxation, or even a fear of unreasonable taxation, could significantly slow the growth of the Internet and electronic commerce. The Internet has a major role to play in promoting the ongoing vitality of our economy and our global competitiveness. The introduction of new taxes imposed solely on the Internet or electronic commerce will inevitably discourage the growth and use of the Internet. While new taxes may initially raise some additional revenue, they have the potential of discouraging growth of the Internet and electronic commerce, thus slowing the growth of the economy, and becoming counterproductive in the long-term. Instead of seeing the Internet as a bountiful new revenue source, we should, instead, adopt policies that encourage its growth and use, which will stimulate economic growth that leads to greater revenues from existing taxes.

Therefore, Treasury is opposed to any new or discriminatory taxes imposed on electronic commerce, whether imposed by other countries or at the federal or subfederal level. Many of our trading partners share this view. Reaching this general consensus was not guaranteed. In the early days of the Internet—just a couple of years ago!—some were considering proposals for a new "bit tax" that would tax each electronic transmission according to the amount of information being transmitted. Needless to say, such a tax would discriminate against the Internet and likely stifle its development. These proposals rightly have been rejected. For example, Ambassador Hugo Paemen, the Head of the European Commission's Delegation to the United States, recently stated that the European Commission has strongly rejected proposals for a "bit tax" because such a tax "could easily nip e-commerce in the bud." The United States has firmly and consistently opposed any efforts to impose any special taxes, whether at the national or the international level, on the use of the Internet.

The fact that not all share the view that taxation of the Internet should be neutral and that no new taxes should be imposed on the Internet reinforces the importance of continuing our efforts at the international level. We work hard, together with our colleagues in the Administration, to dissuade jurisdictions from seeing the Internet as a lucrative new revenue source and choosing to ignore the long-run detrimental effect such a policy would likely have on their economic growth.

Instead of enacting new taxes on the Internet or electronic commerce or providing subsidies, Treasury believes that neutrality should be the fundamental principle guiding the development of tax rules in this area. Ideally, tax rules should not affect economic choices about commercial activities, nor influence market structures. Achieving neutrality in taxation is the best way to see that market forces alone determine the success or failure of new commercial methods. Neutrality can best be achieved through an approach that adopts and adapts existing tax principles—in lieu of imposing new or additional taxes.

The statement that there should be no new taxes on the Internet does not mean that the neutral application of existing taxes should be prevented. On the contrary, it means that any taxation should be applied in a neutral manner, that it should not discriminate against one form of commerce over another, and that it should be fairly applied. These are goals that all governments should pursue in shaping their tax policies.

Neutrality is not the only principle that should guide tax policy. As stated previously, tax rules should also be consistent across jurisdictions and they should be transparent and easy to administer. In achieving these goals, Treasury recognizes that the implementation of basic principles of tax policy may vary at the state level,

although the fundamental principles of neutrality, consistency, and non-discrimination apply at all levels of government.

#### ADVISORY COMMISSION ON ELECTRONIC COMMERCE

We applaud the creation of the Advisory Commission on Electronic Commerce, and look forward to working with you to structure the Commission in a way that meets our mutual goals. As Deputy Secretary Summers stated when expressing his support for H.R. 4105, "In conjunction with this moratorium, we need to establish a commission that will explore the longer-term issues raised by electronic commerce, and develop a policy framework that is fair to states and localities while allowing the Internet to earn its fair place in the ever-changing world." The Commission allows states and localities, industry, taxpayers and the Federal government to work together in finding a solution to these issues.

No one has the intention of allowing the Internet to become a tax haven that will drain states and localities of needed revenues. Indeed, it is vitally important to recognize the legitimate concerns of neutrality and equity that exist. Thus, we are encouraged to see that the issue is on the agenda of the Commission, as it provides a forum for exchanging of views by all interested parties and incorporating those views into appropriate policies.

#### CONCLUSION

The objectives of the Internet Tax Freedom Act are consistent with the general tax policy principles I have described. The Act would impose a temporary moratorium on certain state or local taxes on the Internet or electronic commerce. It would establish an Advisory Commission on Electronic Commerce composed of representatives from the Federal Government, State, local, and county governments, and business and taxpayers who would undertake a thorough study of a broad range of issues concerning the Internet and electronic commerce. Treasury wholeheartedly supports the goals and underlying objectives of both versions of the Internet Tax Freedom Act, and we are ready to work with the Committee to reach our shared objectives.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 15, 1998

The Honorable William V. Roth, Jr.  
Chairman  
Senate Finance Committee  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman,

As the Finance Committee prepares to examine the issue of Internet taxation, I would like to take this opportunity to express the Administration's strong support for the Internet Tax Freedom Act and the important goals it achieves.

As President Clinton has stated, the explosion of commerce over the Internet has the potential to increase our prosperity, to create more jobs and to improve the lives of our people. We would not want duplicative, discriminatory or inappropriate taxation by 30,000 different state and local tax jurisdictions to stunt the development of what he has called "the most promising new economic opportunity in decades." For this reason, the Administration strongly supports a temporary and appropriate moratorium on new or discriminatory taxation of the Internet and electronic commerce. Any taxation of the Internet and electronic commerce must be clear, consistent, neutral, and non-discriminatory.

At the same time, however, we must not allow the Internet to become a tax haven that drains the sales tax and other revenues that our states and cities need to educate our children and keep our streets safe. In conjunction with this moratorium, the legislation establishes a body or commission that will explore the longer-term tax issues raised by electronic commerce, in order to develop a policy framework that is fair to states and localities while allowing the Internet to earn its fair place in the ever-changing business world.

For these reasons, the Administration strongly urges the Senate to pass this legislation so that it can be signed into law this year. While we may have further suggestions, we believe these can be addressed in conference. We look forward to working closely with you and other members on this important issue.

Sincerely,

Lawrence H. Summers

## PREPARED STATEMENT OF FRANK KELLY

Chairman Roth and distinguished members. My name is Frank Kelly, Vice President and Head of the Office of Government Affairs at Charles Schwab & Co., Inc. Thank you for this opportunity to discuss the growth of the Internet and the various tax and trade issues of concern to the online brokerage industry.

In just over two years, Charles Schwab has become the largest online brokerage firm in the world with the most active web commerce site for retail consumers in the nation. In fact, in terms of overall volume, we have become the largest online business—finance or otherwise—in the world. Investors buy and sell more than \$2 billion in securities each week through Schwab's Web site. During the first quarter of 1998, Schwab's Web site handled \$26.2 billion of securities transactions.

The Internet is the next great frontier in the securities market, and we are crossing that frontier now. However, we are gravely concerned that this exciting new means of universal commerce is going to be greatly hindered by burdensome and complicated taxes that would stunt its growth and potential while significantly diminishing the savings and investment of millions of Americans.

## I. BACKGROUND—ONLINE BROKERAGE

Online brokerage is the leading business to be conducted on the Internet. Online brokerage creates tremendous value for investors by providing instant access to current market news, quotes, account balances, trading, SEC filings, consensus earnings estimates, stock price histories, analytical tools, insider activity and industry reports. It allows investors to make more informed decisions by providing access to information such as mutual fund evaluations and analyst recommendations for stocks.

In 1997, Piper Jaffray estimated that online brokerage accounted for 17% of all retail trades, which more than doubled the 1996 share. Investors placed an average of 192,000 trades per day over the Internet during the first quarter of 1998. This is up from 153,000 per day for the last quarter of 1997, a 25% increase in just a few months!

Bill Burnham, a former analyst with Deutsche Morgan Grenfell now with Credit Suisse First Boston, estimates that online trading will account for 25% to 30% of all retail trading in 1998. At Schwab, during the second quarter of 1998, online trading accounted for more than 52% of all retail trades. This works out to an average of 66,000 daily online trades at Schwab.

Credit Suisse Boston analyst Jim Marks predicts that the number of online trading accounts will soar to 25 million over the next 5-1/2 years, from about 4 million today.

At Schwab, our transformation has created profound new value for our customers. When we began to focus strategically on our online services in January 1995, we had approximately 200,000 accounts that traded via our proprietary, PC-based software. Today, we have over 1.8 million active online accounts managing over \$128 billion in individual savings and investment over the Internet.

In the first half of 1998, Schwab opened up a total of 705,000 new accounts. 600,000 are new online accounts representing an additional \$80 billion in assets managed over the Internet.

Of special interest to this committee, of the 705,000 new accounts opened so far this year, 140,000 are Roth IRAs, a vast majority of which are managed over the Internet. Overall, we opened 340,000 total new IRA accounts this year.

Today there are over 60 online brokerages. According to a Time magazine article (5/11/98) commissions from electronic trading were \$700 million in 1997 and will easily exceed \$900 million this year.

## II. BENEFITS OF ONLINE BROKERAGE TO CUSTOMERS

**Lower cost:** The average cost for a trade has been reduced dramatically since the advent of the Internet. In the two years ending in 1997, the average commission ticket has dropped by 70%. This represents a huge savings for online investors.

**Better access to information:** The amount of information provided to individual investors through the Internet is becoming so robust, we can easily envision a day when they will be on par with Institutional investors. Nowhere is this more apparent than our online investors appetite for real-time stock quotes. We deliver as many as 3.6 million real-time quotes a day to individual investors and this number is growing everyday. Only with timely market data, news and analysis can we ever hope to truly create a level playing field for all investors.

**Convenience:** Online investors can check their account balances, analyze a potential investment and place an order for a trade day or night. The convenience of on-

line trading makes it more accessible to all types of traders from the active, daily trader to the buy and hold investor who wants to monitor his progress periodically. Our online customers, as well as all customers at Schwab, are free to take advantage of all our channels including our call centers and branches. In fact, even as the Internet grows exponentially we continue to open new branches. The newest one is in nearby Reston, Virginia.

**Control:** Investors no longer have to feel that investing is a "mysterious" process. The Internet gives investors the ability to make informed decisions about their financial future, chart their own course and monitor their results.

#### IV. INTERNET TAX AND TRADE ISSUES

Great uncertainty currently exists in the electronic marketplace regarding the application of existing and future tax laws on transactions conducted over the Internet as well as the taxation of Internet access services.

As an example, an investor that lives in one state and places a trade while on business in another state could conceivably be subject to two taxes on the one transaction. This example only becomes more complicated when you add on the very common occurrence of interacting with an Internet Service Provider in a third state, a broker in a fourth state, and an exchange in a fifth state. Clearly such taxing schemes would greatly impair the continued growth of the Internet.

These kind of taxes would be especially burdensome for investors who are already subject to capital gains and dividend income taxes. In addition, Charles Schwab & Co., Inc. pays corporate income tax in 47 states. Moreover, any additional Internet taxes would threaten to impair one of the most successful retirement products created in years, the Roth IRA. As I mentioned earlier, Schwab opened over 140,000 new Roth IRAs this year, most of which are managed over the Internet. We believe that each of these accounts and the millions of Americans who rely on the Internet to manage their Roth IRA or other retirement investment vehicles face the very real prospect of watching their investment returns significantly diminished by multiple, overlapping Internet taxes.

Clearly, the Internet is quickly becoming a key medium Americans are increasingly becoming comfortable with to actively manage their personal financial matters—a medium we expect to continue growing at an extraordinary pace in the next decade. Our customer use Schwab online because it is safe, convenient and inexpensive to use. We commend the Finance Committee for holding this hearing to discuss the growth of the Internet and the various tax and trade implications that have arisen with its growth.

I would be delighted to answer any questions you might have. Thank you.

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#### PREPARED STATEMENT OF JILL LESSER

Mr. Chairman and Members of the Committee, thank you for the opportunity to appear before you this morning. My name is Jill Lesser, and I am the Director of Law & Public Policy and Assistant General Counsel for America Online, Inc.

I've been asked to speak this morning about the Internet and electronic commerce—or e-commerce—as it's more commonly known. But before I get into a discussion of why it is that we at America Online believe the interactive medium is going to fundamentally change the way citizens communicate and educate themselves and consumers buy goods and services in this country and around the world, I'd like to offer a personal snapshot of what e-commerce can mean to the average consumer.

I shopped online for the first time early this year. I was (and still am) a new mother, working—as I know you can appreciate—crazy hours and finding myself less and less prepared for the challenges a growing baby presents. I needed a high chair. I needed a stroller. So, I went online at 10:00 p.m. one night. I compared prices and products and a couple of clicks of the mouse later, I had bought exactly what I needed. And of course I never left my living room.

Online commerce was a revelation for me. What it is becoming is nothing short of an economic revolution for both businesses and their customers.

And the number of "connected" consumers grows each and every day. The Internet is becoming a central part of the social and economic life of people all over the world. By the end of 1997, more than 100 million individuals worldwide were connected to the Internet. Some estimates suggest there will soon be one billion users worldwide.

Closer to home, 23 million American households and millions of businesses, schools, libraries and other institutions have access to the Internet, and that number is growing rapidly. Network traffic itself continues to double every 100 days. In

fact, AOL alone processes more than 32 million pieces of e-mail to approximately 105 million recipients a day. And there are over 800 million visits to the World Wide Web through AOL each day. Americans are using this medium as a source of information, a tool of education, a device for entertainment, a means to build community, and as a place to conduct commerce.

Our own members use AOL for a variety of different services every day—from checking out online content and chat, to e-mail and visits to the World Wide Web and more. Increasingly, a significant percentage of the activities that our members engage in online include researching and purchasing products.

Like everything else in this medium which seems to move at lightening speed, on-line commerce is gaining wider acceptance and momentum within the mass market. Online consumer sales are projected to reach \$20 billion by the year 2000, according to research by the GartnerGroup—that's an increase of 233% over this year's estimated \$6.1 billion.

A commercial revolution is underway, redefining the way goods and services are bought and sold. According to Commerce Department figures by the year 2002, \$300 billion worth of business-to-business commerce will be conducted online.

The information technology industry also represents 25% of the real economic growth in the U.S. over the last five years. It generates over 8% of our gross domestic product, 7.4 million jobs paying 60% above the private sector average, and will create another 1.3 million jobs over the next 10 years. And as Commerce Secretary Daley point out, "The information technology sector continue[s] to grow twice as fast as the rest of the economy." And its influence extends to the rest of our economy as well.

Consumers are migrating to this medium to meet their commerce needs for many of the same reasons that I went online to shop for the first time last year. It's convenient, fast, there is an ever-growing selection of goods and services offered online, and consumers' confidence about the security of online transactions is steadily increasing. I should point out that secure technologies within our marketplace as well as the 100 percent Total Satisfaction Guarantee we offer at AOL have gone a long way to allay consumer worries about the security of online commerce.

In fact, more than 40% of AOL's 12 million members have taken advantage of on-line shopping and almost 80% have window-shopped online. With today's technology, we've been able to change the methods and economics of retailing. And, we are starting to see online products and services which are far "better" than their offline counterpart—offering greater selection, better information, lower prices, or different features.

Longer term, the benefits of transacting online will stimulate a consumer behavior shift away from bricks and mortar stores, paper checks/bills and written signatures to a world of digital information and identity storage which has the capability to change how we exchange funds, contract for services and purchase/sell products. Let me give you two quick examples that I think demonstrate how e-commerce is changing the face of retail and transactions.

- Recent one-hour promotions on the AOL service attracted more than 50,000 members to the Preview Travel site for \$99 fares and more than 30,000 to the Music Boulevard site for the Titanic soundtrack. Can you imagine a bricks and mortar store accommodating the crush of 30,000 customers in one hour?
- And, with all due respect to my good friend and colleague Frank Kelly from Charles Schwab, AOL's personal finance area has become a popular destination in cyberspace that enables members to do everything from managing stock portfolios to paying bills online. AOL's personal finance area has 5 million regular users, hosts 6 million online portfolios and serves up 75 million stock quotes daily.

Mixed in with all the good news and excitement that accompanies the tremendous growth and potential of electronic commerce is the very real fact that there are significant challenges to the continued growth of this medium and the subject of this hearing is one of them. As the Committee knows, many tax administrators in state and local taxing jurisdictions have been busy reinterpreting existing statutes that apply to old media to find new sources of revenue in the Internet. These activities have created inconsistent and discriminatory tax policies around the country and brought about the need for the Internet Tax Freedom Act which we believe will help the Internet and e-commerce continue to grow and assist new mothers like me do our shopping 24 hours a day.

I thank you for the opportunity to testify today on this critical application of the online medium and I'm happy to answer any questions you may have.

## PREPARED STATEMENT OF JOHN MCPHEE

Mr. Chairman, Members of the Committee, thank you for inviting the Department of Commerce to speak to you today about the important issue of taxation of electronic commerce. The bills before us, S. 442 and H.R. 4105, would establish a moratorium on the imposition by State and local governments of new taxes on this increasingly vital medium of commerce. I would like to address the international trade aspects of these bills within the global context of electronic commerce. I would defer to the Treasury Department on issues of tax policy.

Internet is quickly becoming the most widespread and accessible information technology medium in the world. It holds the promise of improving many facets of our lives. The private sector is experimenting with the use of the Internet to provide a wide variety of goods and services to consumers. Some 10 million people in the United States and Canada have already bought something on the Internet, and it has been estimated that electronic commerce will surpass \$300 billion worldwide by the year 2002. It is especially important that governments not stifle the development of electronic commerce during these formative stages. This is particularly true in the international trade arena.

We agree with the declaration in the two bills that the Internet should be free of foreign tariffs, trade barriers, and other restrictions. The Administration has already begun work in the World Trade Organization (WTO), in the Organization for Economic Cooperation and Development (OECD), in the Asia-Pacific Economic Cooperation (APEC) forum, and on the Free Trade Area of the Americas (FTAA) to achieve these objectives. Let me briefly outline some of the initiatives we have underway.

Most significantly, we have already succeeded in convincing our fellow members in the WTO to agree to a "standstill" on the imposition of customs duties, thus preserving the Internet as a tariff-free environment for commerce. 132 member countries made the commitment to not impose customs duties on electronic commerce. This is an important achievement.

Also in the WTO, the Declaration that came out of the Ministerial Conference in May calls for a comprehensive work program on the trade related aspects of electronic commerce. This work program will encompass issues relating to trade in goods and services, government procurement, intellectual property, and trade and economic development. The work program will look specifically at how "electronic commerce" fits into the existing WTO framework.

Similarly, the OECD will examine the role of electronic commerce in strengthening the multilateral trading system. The OECD has developed a framework for the taxation of electronic commerce, which as Mr. Guttentag mentioned, will be presented at the OECD conference in Ottawa in October. We support these framework conditions which make clear that any Internet tax should be neutral, fair and simple.

In APEC, an Ad Hoc Task Force on Electronic Commerce is undertaking both substantive work and coordinating with other APEC working groups in a number of important policy areas, including identifying impediments to electronic commerce in the region and facilitating the use of electronic commerce in APEC.

Finally, in the context of the FTAA, a joint government-private sector Committee of Experts on Electronic Commerce has been established. The Committee will make recommendations to the trade ministers on how to "increase and broaden the benefits to be derived from the electronic marketplace" in the western hemisphere and how electronic commerce should relate to the negotiations.

Section 5 of H.R. 4105 would require the Secretary of Commerce to prepare a report on foreign barriers to U.S. trade in electronic commerce and telecommunications services, on their impact, and on measures to foster electronic commerce in the United States and in foreign markets. In our traditional role of promoting domestic and foreign commerce, the Department of Commerce has taken up the responsibility of ensuring and enhancing U.S. competitiveness in the electronic commerce arena. Before commenting on this requirement, however, we need to discuss the matter further with the Office of the United States Trade Representative and others within the Administration to ensure that we do not duplicate existing authorities and ongoing activities.

In conclusion, the Administration wants the Internet to provide an open and stable environment for trade and commerce with a minimum of government regulation. Commerce conducted over the Internet should remain free of tariffs and customs duties, and we would oppose any tax that would apply to electronic commerce in a discriminatory manner. With that in mind, we support the proposals for a tax moratorium and the provisions relating to international trade in electronic commerce in

S. 442 and H.R. 4105, and we look forward to working with the Committee on passage of legislation in this regard.

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PREPARED STATEMENT OF MARK MICALI

I genuinely appreciate the opportunity to provide testimony on behalf of The Direct Marketing Association to the Finance Committee on the important issue of Internet tax legislation.

I am Mark Micali, Vice President, Government Affairs for The Direct Marketing Association (The DMA). The DMA represents over 3,600 corporate members, both domestic and international, who are direct marketers, and their suppliers and support services.

The DMA joins many other industries in supporting a moratorium on the imposition of new state and local taxes on transactions and transmissions that take place over the Internet. Our members' familiarity with the problems that would be caused by the application of taxes in over 30,000 taxing jurisdictions to Internet activities convinces us that the implications for interstate commerce (and international commerce, too) are such that a Federally-imposed "time-out" is essential.

The Internet tax legislation, which passed the House last month, while calling for a three-year moratorium on sales tax on Internet access, does however, create a commission which is empowered to review and recommend mandatory interstate sales tax collection on transactions sold through all forms of communication—mail, telephone, and new medium of the Internet.

Before going further, let me emphasize that The DMA strongly believes a commission should not be ceded the right to make policy on this important prerogative of the Congress. The House-passed measure grants to a commission authority to recommend policy on the critical question of interstate sales tax collection—a matter which has and continues to be under the exclusive jurisdiction of the Congress; and in the case of the Senate, the Finance Committee. Further, the U.S. Supreme Court has spoken twice on the interstate sales tax question in 1967 in the *Bellas Hess* decision and more recently in the 1992 *Quill* case. These decisions confirm that Congress alone has the legislative authority over this important question of interstate commerce.

The DMA strongly endorses the Internet tax legislation introduced by Senators Judd Gregg and Joe Lieberman (S. 1888), as well as the legislation of Senators John McCain and Ron Wyden (S. 442) with both bills calling for a "time-out" in Internet taxation.

The DMA supports the merging of the McCain/Wyden Bill and the Gregg/Lieberman Bill. It is our understanding that the combined legislation would include a six-year moratorium on the imposition of state sales tax on Internet access (from the McCain/Wyden measure), combined with the creation of a commission to study the inconsistencies in the tax treatment by the various states and localities of transactions using the Internet (from the Gregg/Lieberman Bill). The Gregg/Lieberman and McCain/Wyden legislation should be contrasted with the House-passed bill, which creates a commission empowered to review and recommend mandatory interstate sales tax collection—a matter which has been in the jurisdiction of this committee.

In contrasting the Gregg/Lieberman and McCain/Wyden legislation from the legislation passed by the House, it is important to note the genesis of some of the key provisions of that House-passed measure. In particular, earlier this year several organizations representing state and local officials took an aggressive and, in the opinion of The DMA, misguided approach to the subject of Internet taxation. These organizations unfortunately decided to use the Internet tax moratorium issue as a vehicle toward achieving a longstanding goal of gaining a substantial expansion of the taxation of all "remote" sales, including mail order and telemarketing sales, as well as the Internet and other forms of e-commerce. Regrettably, the efforts of these organizations are diverting the focus of Internet tax legislation from its original purpose of keeping this wonderful new form of technology free from burdensome and discriminatory taxes.

While these state and local groups favor Internet tax legislation with a commission empowered to call for mandatory interstate sales tax collection, the combined Gregg/Lieberman and McCain/Wyden legislation takes a different, and in our opinion, better approach. Specifically, the commission envisioned in the combined Senate bill would create a commission to conduct a thorough study of taxation by state and local jurisdictions of communications and transactions using the Internet and online services.



Under a combined Gregg/Lieberman—McCain/Wyden bill the commission would identify inconsistencies in the taxation of Internet and online communications and transactions. With most state and local laws currently applied to the Internet and e-commerce having been enacted long before the Internet was conceived as a vehicle for commerce, a review of the inconsistencies in the application of these laws is a worthwhile function well suited for a commission to review.

Further, the commission called for in this Senate legislation will review inconsistencies in terminology and definitions in the treatment of e-commerce. For example, some states treat the Internet as a form of "telecommunications," while others apply laws to this new medium as a "computer service." Clearly, there is a need for consistent standards and definitions throughout the 50 states.

The Gregg/Lieberman—McCain/Wyden approach asks the commission to develop model state legislation that would provide uniform terminology and definitions in the treatment of the taxation of e-commerce. In so doing, this commission would provide badly needed uniformity throughout the Nation—an assignment well-suited for a Congressionally-mandated commission.

In contrast to the Gregg/Lieberman—McCain/Wyden legislation, the House-passed legislation grants its commission the authority to review and recommend policy on the question of interstate sales tax collection.

The issue of interstate sales tax collection is one of whether a company with no presence or "nexus" in a state—e.g., no stores, no employees, no inventory—should be required to collect sales tax when selling to residents of that state via telephone, mail, or now the new medium of electronic commerce. Very simply, why should a company be "deputized" by a state to collect taxes when it has no stores and no employees in that state?

Worse still, that out-of-state company is not a corporate citizen of the state, and, in effect, has no real standing to lobby that state's legislature in terms of the taxes which may be imposed on it and forced to collect. Imposing this tax collecting requirement on out-of-state companies comes down to an issue upon which our republic was founded: "taxation without representation." Without such representation, tax collecting should not be imposed.

As noted previously, the Supreme Court has ruled on two occasions that when an out-of-state company does not have a physical presence in a state, it is not obligated to collect tax on sales into that state.

Importantly, the Congress in general, and the Finance Committee in particular on behalf of the Senate, have agreed with that reasoning and have over the past three decades refused to grant states the authority to force out-of-state companies to collect sales tax on deliveries into a state. This committee has appreciated the reasoning behind the High Court's decisions and the burden that mandatory sales tax collection would place on interstate commerce.

The issue of the burden of tax collection points to an important foundation of our Nation—entrepreneurship. Such entrepreneurship has been critical to our great economic success. There is no reason to burden new, start-up companies with the requirement to collect taxes across the Nation on behalf of states in which that company has no presence. In essence, we believe it is good public policy to encourage such entrepreneurial activity, not burden it.

While the state and local interests may argue that the emergence of the new medium of the Internet changes the issue of interstate sales tax collection, we in the direct marketing industry view the Internet as yet another conduit to sell goods and services in the long march of technological advancements.

The core issue of whether an out-of-state company should be required to collect tax on behalf of a state in which it has no presence is no different regardless of the medium used to sell the product—be that the mail, the telephone, or the new forms of electronic commerce. This question is a long-standing one of pure public policy. It is not a question of great technical expertise requiring delegation by the Congress to a commission of experts.

We at The Direct Marketing Association believe Congress should adopt Internet tax moratorium legislation that sticks to the point of the original goal of the legislation keeping this new medium of commerce unburdened with often contradictory taxation. We strongly endorse the efforts of Senators Gregg, Lieberman, Wyden, McCain and others to enact Internet tax moratorium legislation that does not invite new and burdensome tax collection.

We strongly support a merged Gregg/Lieberman—McCain/Wyden bill and believe that legislation affecting interstate sales tax policy should be reserved to the purview of the Congress, and this committee in particular, and not ceded to a commission.

**PREPARED STATEMENT OF MARK NEBERGALL**

Thank you, Mr. Chairman, the Ranking Member, and members of the committee: Thank you for the opportunity to appear before you today to discuss the views of the Internet Tax Fairness coalition on the subject of taxation of the Internet.

I am Mark Nebergall, vice president and counsel for finance and tax policy for the Software Publishers Association. My testimony today will focus on five areas:

- The confusing nature of attempts by various states to impose sales taxes on Internet access charges;
- The threat that states may seek to impose sales and use tax regimes on transactions accomplished using the internet that are different than the regimes they apply to mail and telephone order;
- The negotiations between the coalition and the state and local government groups that led to what became H.R. 4105, the Internet Tax Freedom Act, recently passed by the House of Representatives;
- The important policy impact that a Congressional iteration of the principle of neutrality would have on similar debates in the international tax arena
- And the importance of the appointment of a commission to study the patchwork of state and local taxes that could be applied to Internet access and transactions and recommend legislation that to simplify and harmonize such tax regimes.

The Internet Tax Fairness Coalition is a coalition of leading Internet and high-tech companies and trade associations that supports the fair and equitable tax treatment of the Internet and online services. The Coalition believes congressional action is necessary to implement a moratorium to address Internet-related tax issues. Its members include companies such as IBM, Symantec, Ticketmaster, the U.S. Chamber of Commerce, the National Retail Federation and the Software Publishers Association.

The Software Publishers Association, the leading software trade association composed of 1200 companies, ranging from the largest and best known to many other, smaller firms. Its members develop and market software that enables the Internet to operate. SPA's members also utilize the Internet as a low cost medium for distribution of digital products.

As you know, the Internet is a very recent technological advancement in communications. Only a few years ago, the Internet was the province of the Defense Department and university researchers. In just a few years, use of the Internet has exploded worldwide and now it is an ubiquitous medium of global communication for business, education and commerce. The Internet truly has made the world a much smaller place.

The Internet gives even the smallest company the ability to market product to the entire world from a low cost site on the World Wide Web.

Allow me to read from Newsweek writer Robert Samuelson's column in last week's edition:

"[M]y brother Richard... runs a small inn in Cape May, NJ. In the past year, he started advertising on the Internet with his own web site. He's never seen anything like it: almost a fifth of his customers found the inn online. No magazine or newspaper as ever showed remotely similar results. And the Internet is inexpensive. He paid less than \$1,000 to a small company in Indianapolis to create and maintain the site for a year. 'On the Internet, you compete equally [with bigger inns and hotels],' he says, 'You have a page and they have a page.'" (Newsweek, July 13, 1998, page 47.)

Unfortunately, taxation has been slow to react to the explosive growth of the Internet as a medium for conducting commerce. Tax administrators worldwide are struggling to understand electronic commerce and how existing tax rules should be applied to this new medium. In some cases, administrators seek to analogize traditional commerce to electronic commerce. For the most part, the Internet Tax Fairness Coalition believes that existing rules are sufficient to accommodate the taxation of electronic commerce.

One area where existing rules are insufficient to accommodate this new world of electronic commerce is in the area of state sales taxation of Internet access charges. Companies in the business of providing Internet access and other online services, provide a product that, until a few years ago, did not exist. There is no state with a law that specifically imposes a sales tax on amounts paid to such companies for gaining access to the Internet. Several state tax administrators have looked to decades old laws imposing sales taxes on services such as telecommunication, computer or information service, or data processing services and sought to apply them to Internet access services. However, these taxes do not clearly apply to Internet access services. In addition, these taxes are accompanied by inconsistent rules that make compliance confusing and could lead to tax claims by more than one state on the same service charge.

One area where existing rules are sufficient to accommodate electronic commerce is in the area of sales taxation of products purchased using the Internet. Companies use World Wide Web sites to display their products and employ a mechanism that allows a customer to place and order for and pay for a product which the vendor then can be ship or, in the case of digital products such as software, deliver electronically. These transactions are functionally indistinguishable from traditional mail or telephone sales. However, many vendors hesitate to begin offering their products for sale on the Internet because they fear that states will treat Internet sales different from mail or phone sales. This environment of uncertainty deters many companies from venturing onto the Internet as a low-cost marketing and product distribution channel.

As you know, legislation is pending that would address both the issue of confusing and inconsistent state taxation of Internet access charges and the possibility that a state could treat electronic commerce differently from traditional mail and telephone sales. In the Senate, there is S. 442, the Internet Tax Freedom Act, authored by Senators McCain and Wyden, which has been reported by the Commerce Committee and which I understand has been referred to your committee as well. This bill would impose a six year moratorium during which all states would be barred from imposing sales taxes on Internet access charges and would be required to treat Internet sales the same as mail and telephone sales. This bill also would establish a consultative group comprised of federal, congressional, state and private groups prepare policy recommendations on a broad range of domestic and international Internet taxation issues. The Internet Tax Fairness Coalition supports S. 442 as reported by the Commerce Committee

Also in the Senate is S. 1888, the Internet Fairness and Interstate Responsibility Act, authored by Senators Gregg and Lieberman. This bill also would impose a moratorium similar to that described in S. 442. However, this bill would establish a commission that would propose model state legislation dealing with a broad range of issues related to regulation of commercial transactions on the Internet and Internet related services.

Last, there is H.R. 4105, also called the Internet Tax Freedom Act, authored by Rep. Cox, and recently passed unanimously by two House Committees and by the House itself. Mr. Chairman and members of this Committee, I think it is worth repeating this point because it shows the depth of support this bill has gained: In two Committee votes and a vote on the floor, not a single negative vote has been cast against this bill. Not one. None. delete

This legislation would impose a moratorium similar to that described in S. 442 and S. 1888, except that the period of the moratorium would be three years. However, exempted from the moratorium are eight states that would be required to pass within one year legislation affirming their state's policy to impose sales taxes on Internet access charges.

This legislation also would establish a commission to conduct an exhaustive study of state and local taxation that includes Internet transactions and other remote transactions. This commission would propose legislation to Congress on the issues it was formed to study.

The provisions of H.R. 4105 represent a compromise between the Internet Tax Fairness Coalition and state and local government groups. I was a member of the team that met with representatives of state and local governments. We spent countless hours at the negotiating table resolving our differences. With one exception, H.R. 4105 represents legislation that both sides of the table represented that they would support.

The one exception is the grandfather clause for eight states. The coalition opposed any grandfather clause on the ground that it constitutes unsound tax policy to allow the very states causing so much confusion to continue to impose taxes on Internet access charges. The states opposed limitations on the taxing power of those states that already had moved to assert sales taxes on Internet access charges. The provision in the final bill represents a middle ground. It allows eight specified states, Connecticut, North Dakota, South Dakota, Wisconsin, New Mexico, Tennessee, Ohio and Iowa, to continue to impose their taxes; provided their state legislatures, within one year of enactment, pass laws that affirm their state policy to impose taxes that otherwise would be subject to the moratorium.

The reason for the reenactment provision is because, as noted I noted earlier, no state has a statute that specifically imposes a tax on Internet access service. The tax administrators in those eight states have interpreted older statutes dealing with different subject matter as applying to Internet access services. It is not unreasonable to expect state legislation as a prerequisite to qualifying for the grandfather clause. Some or all of those states may decide that it is not their policy to impose a sales tax on Internet access services.

Despite the grandfather clause, the Internet Tax Fairness Coalition supports H.R. 4105.

Mr. Chairman, many have asked why The Internet Tax Freedom Act is so important. In response, I would point to a KPMG Peat Marwick survey of U.S. financial executives that found that ambiguous state and local taxes already inhibit a majority of their companies' efforts with online commerce. Twenty percent were so confused by the tax situation that they did not know if their companies were even subject to taxes for sales over the Internet.

That is a harrowing number and, in and of itself, would justify passage of this bill. However, Mr. Chairman, I would like to go further. Permit me to make the case further for this bill by detailing the problems a variety of industries currently face with discriminatory taxation on electronic commerce.

#### ONLINE BROKERAGE

Online brokerage was one of the first industries to conduct business successfully over the Internet. In 1997, online brokerage accounted for 17% of all retail trades, more than doubling the 1996 share. The online brokerage industry generated an average of 153,000 trades per day during the fourth quarter of 1997, up 60% from the first quarter of 1997.

This rapid growth would not have been achieved had there been burdensome regulations and taxation of online brokerage transactions. This vibrant new industry could be dramatically impaired if America's 30,000 potential taxing jurisdictions were each allowed to develop a unique approach to taxing transactions conducted through the Internet.

For example, an investor in Connecticut may be on a business trip in New York. While in New York, he decides to place a trade through the Internet. That transaction could be routed back to his Internet service provider in Connecticut and then to his online broker in California. Before he places his trade, he decides to research a couple of Internet sites in Illinois, Washington and Florida.

In all, this investor has "touched" six states and numerous local jurisdictions. If each were allowed to tax some portion of this transaction, it would obviously deter the investor from using the Internet for his investments.

## THE ONLINE SERVICE INDUSTRY

As I indicated earlier, Mr. Chairman, The Internet Tax Freedom Act is particularly important for online service providers. More than 23 million Americans log on to the Internet and that number grows every day. While several large companies service this marketplace, there are also more than 10,000 small providers of Internet online services that cater to citizens from New York City and Los Angeles to Anchorage and Tucson.

This past year has seen a flurry of activity by states and localities to tax Internet online services. Most have relied on novel theories of existing laws – such as interpreting existing sales tax statutes to include Internet online services provided through these new Internet technologies.

This has created several problems. First, with more than 30,000 potential state and local taxing jurisdictions in this country, the result is confusion and the threat of taxation of the same service by more than one jurisdiction. Second, these rulings create a potentially devastating financial burden for every member of the industry.

Third, since virtually all attempts to tax have come from reinterpretations of statutes intended to tax other industries, determining compliance has become burdensome, if not impossible. Existing statutes fail to provide specific guidance for determining the situs of an electronic transmission or determining when a service is utilized by a customer. The Internet's lack of geographic boundaries do not fit into traditional definitions.

This is a key point, Mr. Chairman: For some providers of Internet online services, these issues present significant challenges; for others, the tax controversy threatens their very existence. When taxing administrators claim an Internet online service fits into an existing statute, an Internet online service provider can end up being assessed for taxes on services provided years earlier. The service provider, however, cannot go back to its customers and collect those taxes. Therefore, the net result can be that the service provider cannot cover these unanticipated liabilities and is forced out of business.

Mr. Chairman, the enactment of a true moratorium on state and local taxation of Internet online services will provide the opportunity for federal and state policymakers, industry members and concerned citizens to develop a fair and simple tax system. It will present an opportunity to create a win-win situation for all parties.

## THE RETAIL INDUSTRY

Mr. Chairman, electronic commerce promises to play a key role in the future of retailing businesses. A moratorium on discriminatory Internet taxation would ensure that this vital new method of commerce is not hamstrung before it is able to meet its full potential.

Just as electronic commerce's role will expand in other segments of the economy, on-line retail sales are expected to increase at a rapid pace. Forrester Research projects that on-line sales will grow from \$2.6 billion in 1997 to \$4.8 billion in 1998, \$8 billion in 1999, \$12 billion in 2000 and \$18 billion in 2001. That's good news for business and the economy as a whole.

Small businesses in particular are susceptible to devastating loss when exposed to the countless taxing entities who seek a piece of the information superhighway. A small Main Street business simply does not have the resources to deal with the complexities of tax liability in numerous (and often unexpected) locations.

Mr. Chairman, opponents of Internet tax reform make the deceptive case that only big companies use or will use electronic commerce, and that encouraging the development of e-commerce hurts small businesses. This simply isn't the case. The potential benefits of electronic commerce are as real for small business as they are for big business. Any shrewd commercial enterprise, large or small, wants new opportunities to expand sales.

A reasonable policy on Internet taxation will give retailers the opportunity to incorporate an extraordinary new tool – online commerce – into their business. All retailers can use it to their advantage. This is how the industry is evolving, and a sound Internet taxation policy will enable retailers to expand opportunities in a fair marketplace.

### SMALL BUSINESS

Mr. Chairman, taxation policies on the Internet and online service providers will play a significant role in the competitiveness of American business, particularly small business.

America's small business community boasts a rich diversity of categories. These small businesses, which are defined as companies with fewer than 100 employees, have been the engine of U.S. economic growth this decade. In fact, almost all of the net job creation in the 1990's has come from small businesses. In the 1992 - 1996 period, small businesses created 85% of the net gain in new jobs. Furthermore, firms with 1-19 employees expanded employment at an astounding 11.4 percent clip during this time.

The Internet has enabled many of these businesses to compete effectively in the electronic marketplace. This has led to new markets for small businesses and has generated even more jobs for this sector of our economy. A March 1998 survey by E-valuations Research Inc. indicates that 54 percent of small business owners and managers believe they would experience a sales increase by adding an e-commerce-enabled web site.

Unfortunately, small businesses are faced with the prospect of meeting collection obligations from more than 30,000 state and local taxing jurisdictions. Such an administrative nightmare would prove overwhelming for any small business. Furthermore, the confusion involved in determining collection obligations, coupled with the added costs of new taxes, would deter small businesses from venturing into the electronic marketplace. The uncertainty and financial burden would slow the growth of electronic commerce, thereby making the American private sector less competitive in the global marketplace.

Mr. Chairman, the establishment of a true moratorium on state and local taxes on the Internet or interactive computer services would not only lessen the burden that these inequitable technology taxes have on electronic commerce, it would also facilitate a proper assessment of their impact and lead to well-reasoned policy recommendations. Such an approach would enable small businesses to survive and grow in the electronic marketplace.

### THE REAL ESTATE INDUSTRY

Mr. Chairman, while the typical real estate transaction does not occur over the Internet, many activities leading to the main transaction do. That is why the real estate industry is so concerned about discriminatory taxation on the Internet, specifically on Internet access.

Consumers today are using the Web to expand dramatically their research and viewing of real estate properties. The Internet is particularly helpful for home buyers without a car or means to travel.

The Internet has revolutionized the flow of information between the real estate industry and the taxpayers that it serves (i.e., anyone who owns a home or seeks to buy or sell a home). In March 1998 alone, the website REALTOR.COM, which lists more than 1,100,000 homes online, received 231 million hits. During the same period, homes listed on REALTOR.COM were viewed an average of 80 times by over 2 million consumers.

During the same period, One Realtor Place, the site that serves real estate professionals, received more than 1.5 million inquiries. This incredible flow of information is good, both for the industry and for the prospective buyers and sellers of real estate. Without a doubt, the Internet has changed both the real estate industry and the way in which home buyers shop for a home -- the single largest investment of their lives.

Mr. Chairman, before those seeking revenues implement a patchwork of potentially stifling taxes for the Internet, it is imperative that there be full consideration of how this could affect the growth of this new marketplace.

## THE HOSPITALITY INDUSTRY

Mr. Chairman, the Internet is a tool of growing importance to the hospitality industry. It is estimated that Internet commerce in the lodging industry reached \$345 million in 1997 and will grow to \$2.9 billion by 2001. The travel industry is a leader in electronic commerce and is expected to reach almost \$9.0 billion in Internet business by 2002.

Earlier, I cited a passage from a column by Robert Samuelson in Newsweek concerning his brother who owns a small inn in Cape May, NJ. Numerous inns and bed and breakfasts have found that putting up a web page widens their potential customer base enormously. These small business persons know that a web page allows them to reach far more people far more effectively with marketing materials such as printed brochures. Asking such small business operators to collect taxes from hundreds, even thousands of different jurisdictions would mean the end of their use of the Internet.

For the hospitality industry, the primary goal of The Internet Tax Freedom Act is to ensure that a guest who makes a reservation over the Internet pays the same taxes as the guest who makes the reservation over the phone or by walking up to the check-in counter.

The Internet Tax Freedom Act protects online consumers from the problems I have just outlined, including state or local tax levies based solely on the path in cyberspace through which orders are routed.

Mr. Chairman, there is something else that is protected by The Internet Tax Freedom Act -- the traditional sale/use tax base. This is an area that, frankly, has been a focus of great misrepresentation during the debate over Internet taxation. Therefore, permit me to outline why The Internet Tax Freedom Act would in fact be a great safeguard for states and localities concerned about their revenues:

## THE TRADITIONAL SALE/USE TAX BASE

Mr. Chairman, state and local tax administrators claim that provisions of the Internet Tax Freedom Act would cause serious erosion of their sales and use tax base. This claim is false. The only impact the Internet Tax Freedom Act would have on the ability of state and local tax authorities to collect a sales or use tax would be to bar the imposition of such taxes on Internet access charges. Internet access charges represent only a very tiny portion, if any, of the sales and use tax base.

In fact, except for Internet access charges, the impact of the Internet Tax Freedom Act is quite clear: The ability of state and local tax authorities to collect sales and use taxes is preserved. The Internet Tax Freedom Act contains a savings clause that preserves the right of state and local jurisdictions to collect sales and use taxes on goods and services contracted for using the Internet.

The chief complaint of the states is that current law does not allow them to impose on out-of-state sellers the obligation to collect and remit taxes owed by their customers unless the out-of-state seller also maintains some physical presence in their state. Many out-of-state sellers are very careful about which states they choose to maintain a physical presence to prevent incurring such a tax collection and remittance obligation.

Mr. Chairman, the Internet Tax Freedom Act would require that states treat Internet purchases the same as telephone or mail purchases. If the Internet vendor has a physical presence in the state where the customer resides, then that vendor can be made to collect from the customer and remit to that state any tax that might result from the purchase.

On the other hand, if the Internet vendor has no physical presence in the state where the customer resides, no such obligation to collect and remit taxes can be imposed. The Internet Tax Freedom Act would mandate a result consistent with mail order purchases. The Internet Tax Freedom Act would not otherwise restrict any right that states currently have to sales and use tax revenue.

All of the bills I previously described would require that states, during the moratorium, for sales tax purposes, treat Internet sales the same as mail and telephone orders. While we are aware of no state that has attempted apply such different treatment, a federal statute that mandated neutral treatment would remove the uncertainty that has deterred many companies, especially smaller business, from venturing into electronic commerce.

Even more importantly, federal legislation in the United States which mandated neutral treatment would send a signal to our trading partners on an important tax policy issue. Many foreign countries also are struggling with interpretation of their tax laws in light of the explosive growth of the Internet and electronic commerce. Congress would enhance the weight of US advocacy here by giving its imprimatur to this "principle of neutrality."

Last, our coalition believes that a commission to study and make recommendations with regard to state and local taxation of electronic commerce is a necessary step in resolving the current patchwork quilt of laws that inhibit the growth of the Internet. The Supreme Court has ruled that this patchwork can impose unreasonable burdens on interstate commerce. Our coalition favors the removal of such burdens on interstate commerce. We believe that a properly constituted commission charged to study these complex issues and to make recommendations for simplification could help resolve this quagmire.

We note that the House bill, H.R. 4105, gives its commission only two years to complete its work. Given the complexity of the issues, we are concerned that this commission will have insufficient time to give the issues the thorough attention they deserve. We urge you to consider reporting a bill that gives the commission more time to complete its work. We acknowledge that this may require a moratorium longer than the three years called for in the House bill.

Mr. Chairman, this completes my prepared statement. I am pleased to answer any questions you or the other members of the committee might have. Thank you for the opportunity to appear this morning.



PREPARED STATEMENT OF RAYMOND C. SCHEPPACH

Thank you for this opportunity to appear before you today on behalf of the National Governors' Association.

At the winter meeting of the National Governors' Association in February, the nation's Governors went on record agreeing to a moratorium on new taxes on Internet access, not because these local taxes interfered with interstate commerce, but because we understood the concerns of the Internet business community that there are 6,000 state and local jurisdictions with the authority to levy a sales tax. As the record shows, only a small number of these jurisdictions actually levy such a tax on Internet access, and none has the authority to require an out-of-state vendor to collect their taxes on goods sold into their jurisdiction. Nonetheless, our proposal was a good faith effort to work with industry. We offered this moratorium in exchange for the establishment of a commission that would address the authority of states and localities to require remote sellers to collect sales tax if that tax were seriously simplified and streamlined. All the other state and local government associations have joined in this agreement. It is our hope that federal legislation can reflect this proposal.

I'd like to talk first about the current status of state and local taxes affecting the Internet, then review the legislative proposals being considered in the Senate.

IS FEDERAL ACTION NEEDED?

State and local elected officials strongly support the development and growth of the Internet. Increased access to reliable, high-speed communication services is key to job creation and the delivery of more cost-effective public services. In the near future, all levels of government expect to use the Internet to deliver a broad range of services. For states and localities, these include administering motor vehicle registrations; enhancing distance learning; improving health services through telemedicine; enabling one-stop shopping for construction permits, fees, and environmental permits; and simplifying registration and eligibility for social services and children's services. And high-speed and low-cost telecommunications services are a prime ingredient for attracting business to urban as well as rural settings. Because we recognize our need for the Internet, state and local government competition is already protecting Internet businesses from unfair tax burdens.

The fact is that neither states nor localities are targeting the Internet for new or increased taxes. If you look at the record over the past few years, quite a few states have in fact reduced or eliminated taxes on Internet businesses or Internet access. Since the beginning of 1997, Connecticut, Florida, Georgia, Massachusetts, and Washington have each passed laws removing taxes from the Internet. A Florida statute removes Internet access fees from the definition of taxable telecommunication services. In Massachusetts, a statute eliminates all taxes on Internet access, online information, and sales over the Internet over the next five years. A Connecticut law also eliminates taxes on Internet access charges and online information charges over five years. The same Connecticut law also exempts the costs of developing, establishing and maintaining websites from sales taxation. Georgia and Washington have both passed legislation expressly removing Internet access from the application of the state sales tax. New York Governor George Pataki lifted New York state taxes on the Internet by executive order, including taxes on transactions taking place over the Internet. And the California legislature is still considering a bill to roll back taxes on the Internet.

Compare those actions to the fact that today, only 11 states have taxes on Internet access along with 13 home-rule cities in the state of Colorado. In 1997 no state and only one city took action to tax Internet access, and that city reversed its decision within 30 days. So far in 1998, no city or state has passed legislation to tax the Internet. The record shows that states and localities are lowering their taxes on the Internet. Nevertheless, congressional committees continue to consider legislation to address the "problem" of state and local taxes potentially threatening the future growth and development of the Internet.

At the state and local level, we have heard little evidence of double taxation on Internet businesses or Internet transactions. The fear that 30,000 taxing jurisdictions could threaten the development of the Internet is an unfounded one. Most transactions take place between two parties—a buyer and a seller. Occasionally multiple parties are involved, but it is nearly always a small and manageable number. The only taxes that could be involved in such a transaction are the taxes of the states and cities in which those parties are located. In fact, in nearly every case, the purchaser's location alone determines the tax consequences of a transaction. The concern that multiple jurisdictions will somehow be taxing single transactions has yet to be demonstrated. Before federal legislation is adopted to prevent such a prob-

lem, there should be some evidence of a problem. We ask you to look closely at this issue.

We have noticed that none of these proposed bills to protect the Internet has included restrictions on federal taxing authority, for instance, the collection of the federal airline ticket tax for tickets sold over the Internet. Apparently what is good for the states and cities is not good for the federal government. We also notice that at the same time there is pressure to stop state and local taxation of Internet access, the federal subscriber line charge on individual telephone lines increases by the number of lines into a household. Thus, if a family decides to get a second line to permit them to make greater use of the Internet, the federal tax on that line is \$5.40 per month, compared to \$3.50 for the primary phone line. This looks to us like a federal Internet access tax that is not prohibited by this legislation.

#### LEGISLATION PROPOSED IN THE SENATE

Last November, the Senate Commerce Committee adopted S. 442, the Wyden bill. That bill contains a six-year moratorium on the authority of states and localities to tax any business that is connected with the Internet. The National Governors' Association opposes this bill. Our first concern is that this moratorium is much too long. In six years, the question of taxation of Internet transactions will be answered. There will be no taxes, and all other retail businesses in the United States will be at a permanent disadvantage. Growth in Internet use and Internet transactions is expected to explode in the next five to ten years. Estimates by Internet marketing research firms project that electronic commerce within the United States will total \$300 billion by 2002, and that World Wide Web sales will be \$1.5 trillion. The rapid growth of the Internet and electronic commerce means that we must address this problem of tax equity in the next few years. A six-year moratorium means it will not be addressed.

Our second concern is that S. 442 contains a broad preemption of state and local taxing authority, while the record shows that there is little tax burden on the Internet today. The bill the Senate Commerce Committee passed attempts to create a list of authorized state taxing powers. Nowhere does such a list exist today, and the authors of our Constitution would be deeply troubled to see such an effort made in legislation. The structure of S. 442 is unworkable and would only lead to years of litigation as each state and locality could be forced to defend each and every tax against this brief list of "approved" taxes. If there is a problem with state and local taxes, Congress should name the problem taxes.

Finally, the commission in this bill fails to address the existing tax inequity which makes the issue of Internet taxation so troublesome—the issue of remote sales. Today, more than 90 percent of most products are sold in stores, and if products are sold in a state that has a sales tax on that particular product, those sales are taxed. These taxes are what pay for the schools and hospitals, police services, and roads that our citizens depend on for their personal safety and to make commerce possible. However, if a product is sold into a state by a vendor with no physical presence in a state, the sales tax is not collected. The tax is due, but it can't be collected. This unfairness must be corrected, and our proposal for a streamlined, simplified sales tax with uniform definitions of goods and services across all participating states, simplified audit and collection procedures, and one sales tax rate per state is designed to make the sales tax collectible by remote vendors. That solution needs to be examined, and S. 442 does not permit that examination.

A few months ago, Senator Gregg and Senator Leiberman introduced S. 1888. The nation's Governors oppose this bill as well. This proposal again contained a long six-year moratorium tied to a broad preemption of state and local government taxing authority and the same ill-advised list of "approved" state and local taxes. The commission it proposed offered an opportunity for business executives and state and local officials to work toward a solution to the taxation of electronic commerce, but not remote commerce. The membership on the commission ignored Main Street businesses, and the projects outlined were very technical, such as "developing model legislation."

Since late 1996, state and local governments have been involved with a broad array of business and academic leaders in the field of taxation to develop such model legislation. This effort, under the auspices of the National Tax Association, is a much better arena for such technical tasks as developing model legislation. The commission this legislation should call for needs to look at the issue of equity in tax treatment, not just the peculiarities related to the technical functioning of the Internet. And to do that, the commission must have representation from Main Street businesses as well as Internet businesses and other remote sellers, such as direct marketers.

Over the past few months, a number of draft amendments to S. 442 have been reported in the press and on one occasion shared with staff of our national associations. The changes in this amendment do not address our consistently stated concerns: the moratorium remains too long, the preemption established by the bill is much too broad and will lead to expensive litigation for both business and government, and the commission proposed is not capable of addressing the real problem that Internet growth has exacerbated—collection of sales taxes by remote sellers. Therefore, Governors oppose these bills.

#### H.R. 4105

Legislation passed by the House takes a major step toward responding to the concerns we have voiced for the past 18 months. First, the moratorium it proposes is three years long, linking it to the two years needed for a commission to develop potential solutions and a third year for congressional consideration of these proposed solutions. A moratorium of this length gives all parties the incentive to reach a mutually acceptable solution. Second, the moratorium is only on new taxes on Internet access, a clearly defined preemption, and on discriminatory and multiple taxes. The moratorium protects existing taxes that have actually been enforced as we have consistently requested. Finally, H.R. 4105 contains a commission that is authorized to study the serious underlying issue of equity in tax treatment among electronic commerce, remote sellers, and other forms of commerce. These are important improvements over all other drafts of the Internet Tax Freedom Act, and they were developed in negotiations with the Internet industry and with direct marketers. We urge you to adopt the structure and approach of this bill.

We do have some narrow and specific concerns about H.R. 4105, and I want to make these clear to you today. We believe that with these few changes, state and local governments can support federal legislation.

Our first concern is that the language of the bill should protect all existing state taxes and home-rule taxes on Internet access actually enforced before March 1, 1998, a clear and measurable guideline. Federal legislation should not attempt to isolate and identify each and every statute by reference for inclusion in the act itself. This approach, with additional report language identifying the public notice required to attain the status of "actually enforced," is a clear bright line for industry. Home-rule cities must be retained in the legislation because they are a part of the constitution of many states, and neither state legislatures nor Governors can change their autonomy.

Second, the requirement that each of the "grandfathered" jurisdictions must reenact their tax laws in order to have them continue during the moratorium is inconsistent.

If the federal government recognizes these few jurisdictions as having existing taxes, they should be able to remain in force. To require the enactment of new statutes by cities and states that have already enacted such statutes, and then expect these governments within three more years to enact new statutes again in response to the commission's recommendations is overly burdensome. The taxes that have been identified fall far short of the threat of 30,000 taxing jurisdictions on which this legislation was originally predicated. Existing taxes should remain in effect.

Third, specific language needs to be added to ensure that the moratorium in the bill will have no impact on tax liabilities which arose from tax laws in effect before the date of enactment of this act. The moratorium should apply only to taxes on services delivered on or after the date of enactment of this bill.

Fourth, one phrase needs to be removed from the definition of multiple taxation, "pursuant to a law referred to in section 151(b)(1)." Without this change, the definition of multiple tax will include the situation where a state sales tax and a local sales tax that both apply to a transaction would be considered multiple taxes. Businesses today have no trouble collecting the local sales tax along with the state sales tax. No industry has ever claimed that this constitutes a "multiple tax." The sentence should be removed.

Fifth, the definition of taxes must be narrowed. The language in H.R. 4105 would treat charges or fees that are paid in return for a specific privilege, service, or benefit conferred as if they were as a general tax levy. These fees must not become factors in the determination of multiple or discriminatory taxation.

Sixth, the business members of the commission fail to include representation of Main Street businesses. We ask that perhaps the numbers for the first two categories be reduced one each and that, with this greater flexibility for appointments, a phrase be added that two of the members of the commission be from companies with operations in more than 25 states.

Finally, we ask that membership on the business side be limited to "chief executive officers of companies . . ." rather than "individuals employed by or affiliated with companies . . ." Governors, state legislators, mayors, and county commissioners will each serve on this commission, and the level of decisions required to reach consensus on these difficult issues will require individuals with broader authority to represent the companies than would result from the current language in H.R. 4105.

Thank you again for this opportunity to testify on behalf of governors, and I would be glad to try to answer your questions.

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PREPARED STATEMENT OF HON. RON WYDEN

Thank you for the opportunity to testify before the Committee today.

I want to begin by outlining briefly a few real-life cybertax problems.

Imagine this scenario: you and a friend run a small, home-based business in Rapid City, South Dakota. You decide to send a token of appreciation to a favorite customer in Ames, Iowa and log on to the Internet using an Internet service provider in Alexandria, Virginia. After finding the home page of Harry and David's in Medford, Oregon, you order a gift basket for your customer and pay for the purchase with your online banking service in Charlotte, North Carolina. How many of those cities and states get to tax this transaction—and who is responsible for collecting them?

Here's another: you are an executive from Connecticut who travels to Texas for an important business meeting. If you take your laptop and dial up Internet access in your Houston hotel room to check on some last minute financial details via e-mail messages. In this instance, you will be taxed twice: Connecticut taxes you for Internet access service at your billing address and Texas imposes the tax whirls vail access the Net.

Here's another: you have subscribed to the Wall Street Journal for years by writing a check and sending it through the mail. You haven't paid a tax on that subscription. But you decide to renew your subscription online. Connecticut taxes that subscription as a data processing service. You now owe a tax you never paid before.

The situation becomes even more complicated as we cross the waters' edge. The German Finance Ministry, for example, is working on a radical new plan to create a global Internet tax as soon as possible. What would happen if a French executive travels to Texas and goes on-line through his Belgian Internet service provider to order a product from a German company that has a Web page on a server in Connecticut? Who is liable for paying which tax, where, and to whom? Add to this the fact that these scenarios deal only with taxes on Internet access or the sale of tangible products online. What about downloading information like a compact disk or an article online, or fees charged for playing a video game?

And then there is the problem of retroactive Internet taxes. James Walton, a small businessman from a small town near Nashville, Tennessee, is a good example. He began an Internet access business in 1991. In 1992, his accountant checked with the Tennessee Department of Revenue about whether he should collect sales tax for his services. Their opinion was that he was not a taxable service. The Revenue Department reaffirmed that view in two subsequent opinion letters in 1994 and 1996.

But Internet use was growing, and in October 1996, the Tennessee Revenue Department audited him. The concluded that everything was in order except that now he owed back taxes and interest since 1993! This reversal put Mr. Walton out of business. And he is not alone.

Current estimates are that cyber-commerce will generate as much as \$1 billion this year and soar to nearly a trillion dollars by 2002. Some successful e-merchants have online transactions topping several hundred million dollars a year, but much of the commerce carried out over the Internet is done with small businesses. This dizzying growth of electronic commerce has transformed the World Wide Web into a world wide wallet in the minds of tax collectors from Milwaukee to Munich. But with more than 30,000 different jurisdictions in the United States alone, taxing the Net is tricky and could kill the goose that has just begun to lay golden eggs.

Consumers and businesses alike face mounting uncertainties about the taxation of cyber-commerce. That is why Senators Gregg, Lieberman, McCain, Burns, Leahy, Abraham, Kerry, I and others believe we should pass the Internet Tax Freedom Act quickly. This bill that would call a time-out on non-technologically neutral taxes. This legislation would establish a six-year moratorium on taxes that discriminate against the Internet. During the time-out, a bipartisan commission made up of consumer and business groups and state and local taxing authorities would sift through the myriad complexities and inconsistencies in Internet taxation and provide rec-

ommendations to Congress. The goal is to establish some common terms and definitions for everyone to use so that the act of dialing-up your Internet Service Provider, or ISP, is not treated as data processing in one state, as telecommunications service in another, and as Internet access in a third. If the commission chooses to recommend cyber taxes, then the commission must assure they are nondiscriminatory, uniform, fair, and administrable.

In addition, the Internet Tax Freedom Act addresses international taxation of the Web. We believe that the United States must create an example for the rest of the world by preventing discriminatory taxation of online services, Internet access services, and communications and transactions using the Internet so that the United States can persuade our trading partners to resist the temptation to tax such activities and thereby limit the potential growth of such activities. The bill directs the President to seek bilateral and multilateral agreements through the World Trade Organization, the Organization for Economic Cooperation and Development, the Asia Pacific Economic Cooperation Council, and other appropriate international organizations to establish that communications and transactions using the Internet, online service, and Internet access service are free from tariffs and discriminatory taxation.

One can never underestimate the desire of some politicians, in the United States and abroad, to invent new ways to tax, and our approach has run up against some powerful opposition. Although the bill specifically and surgically targets the moratorium on only those taxes which are not technologically neutral, some politicians just can't keep their hands off the Internet.

Opponents of the Internet Tax Freedom Act argue that competition from online business will hurt Main Street stores because they won't be subject to the same taxes, but that is not true. Every online retailer has a physical presence somewhere, making it subject to income, property, business license, sales, and other taxes. And a Main Street, America store that goes online and boosts sales will generate even more taxable income. Having the ability to reach millions of new customers through a few computer clicks gives a small town shopkeeper the chance to compete against the giant superstore chain at the edge of town and across the globe.

High-tech savvy Governors like George Pataki of New York, Pete Wilson of California, Jim Gilmore of Virginia, Paul Celucci of Massachusetts, and George Bush of Texas, who collectively represent over 25% of the nation's population, have given a strong endorsement to the bill. President Clinton has also come out in favor of a moratorium. Dozens of state legislators from around the country have also weighed in with their support for this bi-partisan legislation. The Internet Tax Fairness Coalition, composed of dozens of trade associations, has gone on record in support of the legislation. They all see the futility of the taxocrats trying to shoehorn a 21st Century technology into a tax code made for the Model T.

The Internet is fast becoming the business infrastructure of the new digital economy. It is changing the way we communicate, the way we obtain information, and certainly the way we do business. Cyber-commerce holds tremendous potential for small business, people living in rural America, and the elderly and disabled. It is incumbent upon us to get it right so that we do not allow a feeding frenzy by state and local tax collectors across the world to turn the information superhighway into an empty 21st Century toll road.



COMMUNICATIONS

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# CRS Report for Congress

## Internet Tax Bills in the 105<sup>th</sup> Congress

Updated July 8, 1998

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Congressional Research Service • The Library of Congress

## ABSTRACT

This report tracks the evolution and content of the Internet tax freedom bills. In general, the bills would impose a federal moratorium on the ability of state and local governments to impose taxes on certain aspects of the Internet and would establish a temporary federal commission to study selected issues and make policy recommendations. This report traces the bills introduced in the 105<sup>th</sup> Congress, including H.R. 1054, H.R. 3529, H.R. 3849, H.R. 4105 (passed by the House on June 23, 1998), and S. 442, and S. 1888 in the Senate. The report presents background on issues of concern to different interest groups regarding state and local taxation of the Internet; identifies the major components of the legislation and compares the positions taken in each of the bills; explains reactions to the proposals; and summarizes congressional activity to date on each of the bills. This report will be updated as events warrant. For a description of the main elements of H.R. 4105, see CRS Report 98-597, *Internet Tax Freedom Act: H.R. 4105 as Passed by the House*, by Nonna A. Noto.



## Internet Tax Bills in the 105<sup>th</sup> Congress

### Summary

Several bills to regulate state and local taxation of the Internet have been introduced in the 105<sup>th</sup> Congress. The House passed its version of the Internet Tax Freedom Act, H.R. 4105, on June 23, 1998. It was preceded by committee consideration of H.R. 1054, H.R. 3529, and H.R. 3849. S. 442 and S. 1888 have been introduced in the Senate.

The bill approved by the House and the bills under consideration by the Senate agree in general structure, but differ in their details. Each bill would place a temporary moratorium on the ability of state and local governments to impose certain taxes on the Internet and related activities. In each bill the moratorium is intended to allow time for a study commission to make recommendations regarding taxation of the Internet.

Apart from these points of agreement, there are significant differences among the bills on such basic issues as: the length of the moratorium; which aspects of the Internet are to be protected from taxation; which types of taxes would be prohibited and which permitted; whether existing taxes would be grandfathered; the focus of the consultative group or commission; the membership of the consultative group; and what policy actions are expected at the end of the moratorium.

The original companion bills, H.R. 1054 and S. 442, were introduced in March 1997. Subsequently, both were revised in response to criticisms by state and local interest groups. In the spring of 1998, two new bills were introduced in place of H.R. 1054: H.R. 3529 in the House Judiciary Committee and H.R. 3849 in the House Commerce Committee. The Commerce Committee reported H.R. 3849 on May 14, 1998. The Judiciary Committee substantially amended and reported both H.R. 3529 and H.R. 3849 on June 17. H.R. 4105, passed by the House on June 23, combines elements from H.R. 3529 and H.R. 3849.

The House-passed bill incorporates a version of the proposal advanced by the National Governors' Association in February 1998: before the end of the moratorium, an advisory commission would propose legislation to Congress to help a state require out-of-state vendors to collect sales and use taxes— if the state simplifies its state and local tax administration procedures. H.R. 4105 also addresses Federal Communications Commission (FCC) and telecommunications issues and international electronic commerce.

In the Senate, the version of S. 442 approved by the Senate Commerce Committee on November 4, 1997, continues to be revised before being presented to the full Senate. S. 1888, introduced in May 1998, draws heavily upon the original bill language of S. 442 describing the moratorium and exemptions. S. 1888 also includes a more detailed description of the membership and agenda of the study commission, including developing a uniform commercial code for electronic commerce. Parts of S. 1888 may be included in S. 442 before it reaches the Senate floor. The Senate bills do not address sales and use taxation of remote commerce, FCC regulation of the Internet, or the study of foreign electronic commerce. The Clinton Administration has indicated its general support for the Internet tax freedom bills.

## Internet Tax Bills in the 105<sup>th</sup> Congress

Several bills to regulate state and local taxation of the Internet have been introduced in the 105<sup>th</sup> Congress. The House passed its version of the Internet Tax Freedom Act, H.R. 4105, on June 23, 1998;<sup>1</sup> it was preceded by committee consideration of H.R. 1054, H.R. 3529, and H.R. 3849. S. 442 and S. 1888 have been introduced in the Senate.

Each bill would place a temporary moratorium on the ability of state and local governments to impose certain taxes on the Internet and related activities. In each bill the moratorium is intended to allow time for a study commission to develop and make recommendations regarding taxation of the Internet.

Apart from these points of agreement, there are significant differences among the bills on such basic issues as: the length of the moratorium; which aspects of the Internet are to be protected from taxation; which types of taxes would be prohibited and which permitted; whether existing taxes would be grandfathered; the focus of the consultative group or commission; the membership of the consultative group; and what policy actions are expected at the end of the moratorium.

This report begins by highlighting issues underlying the legislation, represented by the concerns of four different interest groups. It then identifies the major components of the legislation and compares the positions taken in each of the bills. Next, it explains reactions to the proposals. Finally, it summarizes congressional activity to date, by bill number.

### State and Local Taxation of the Internet

The current debate over state and local taxation of the Internet involves several quite different concerns, including those of the following four groups: the Internet business community, the Clinton Administration, state and local revenue officials, and competing sectors of the economy subject to tax.

The Internet business community has expressed concern that the states will design discriminatory taxes tailored to the Internet. It is also concerned that because Internet commerce transcends state boundaries, it will be subjected to multiple taxation, or taxes levied in a haphazard, nonuniform manner by myriad state and local taxing jurisdictions. It suggests that the high cost of complying with disparate state and local tax laws will discourage the development of Internet enterprises, especially

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<sup>1</sup>For summary of the bill, see CRS Report 98-597, *Internet Tax Freedom Act: H.R. 4105 as Passed by the House*, by Nonna A. Noto.

by small businesses. Some interpret this position as a request for a uniform system of state and local taxation, with simplified compliance procedures. Others interpret it as a request for no taxation at all.

The Clinton Administration is concerned with promoting U.S. economic development and international trade by nurturing the development of electronic commerce in the United States. The Administration is sympathetic to the infant industry argument that fledgling efforts to develop Internet-related businesses could be stifled by complicated taxation and regulation of the Internet. The Administration is particularly concerned with protecting from taxation services that are delivered entirely over the Internet, as distinguished from products that are ordered over the Internet but delivered separately in tangible, physical form. Internationally, the Administration wants to forestall efforts by other countries to impose taxes, tariffs, and regulations on Internet commerce. Pre-empting state and local government taxation of the Internet is a way of setting at home the example the United States would like other countries to follow.<sup>2</sup>

For the federal government, opposing new forms of taxes on the Internet currently appears to pose relatively little threat of revenue loss. Unlike many other industrialized countries which depend heavily on value added taxes, and the states which depend heavily on sales taxes, the U.S. Treasury does not depend much on sales or other transactions taxes. The federal government feels it will receive its fair share of revenues from business conducted over the Internet through income taxation of business profits. The Governors of some states (California, New York, Texas, South Carolina, and Virginia, among others) agree with this position.

State and local revenue officials are concerned with retaining the authority to determine their own tax policy and adapt it to a changing economy. They have generally opposed the idea of a federally imposed moratorium. They are particularly concerned about stemming further erosion of their sales tax base, as has occurred with mail order sales. State and local governments worry that the growth of commerce conducted over the Internet will increase the share of purchases their residents make out-of-state, tax-free, unless Congress changes the nexus rules governing interstate tax collection requirements. Under the proposed moratorium, they could also lose the ability to tax within-state sales transacted entirely over the Internet. State and local governments are also concerned about erosion of their telecommunications tax base.

Sectors of the economy that are otherwise subject to tax are concerned that they will face a competitive disadvantage and thus lose sales to business conducted tax-free over the Internet. The taxed group includes "Main Street" (storefront) retailers, businesses that deliver their product in tangible rather than electronic form, and communications industries such as telephone and cable television. These competing sectors seek equal treatment under the tax laws.

A basic conflict underlying the debate over state and local taxation of the Internet is between:

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<sup>2</sup>The Clinton Administration's position is set forth in: The White House, "A Framework for Global Electronic Commerce," together with Background Paper, released July 1, 1997.

- what tax base will remain available to state and local governments as a growing fraction of the economy operates over the Internet;
- versus
- the potential tax compliance burden for businesses conducting commerce over the Internet throughout the nation and the world if they are subject to the laws and filing requirements of numerous distinct taxing jurisdictions.

Among the tax administration issues of concern are:

- inconsistencies among tax jurisdictions in the terminology defining the tax base; and
- how to determine which jurisdiction is entitled to impose a tax when the geographic location of the Internet activity is ambiguous.

## Contents of the Bills

Before taking a closer look at the contents of the bills, the reader is cautioned that the Senate bills are still being revised. The discussion that follows is based on the most recent official versions of the bills available as of this writing:

### House of Representatives

- H.R. 1054 (Cox) as approved by the House Commerce and Judiciary subcommittees on October 9, 1997;
- H.R. 3529 (Chabot) as introduced in the House Judiciary Committee on March 23, 1998;
- H.R. 3849 (Cox and White/Commerce) as reported by the House Commerce Committee on May 14, 1998;<sup>3</sup> and
- H.R. 3529 (Judiciary substitute) as reported by the House Judiciary Committee on June 17, 1998. This was approved by the Judiciary Committee as an amendment in the nature of a substitute.
- H.R. 4105 (Cox) as passed by the House on June 23, 1998.

### Senate

- S. 442 (Wyden) as approved by the Senate Commerce Committee on November 4, 1997; and
- S. 1888 (Gregg and Lieberman) as introduced on March 31, 1998.

(S. 442 continues to be revised. Portions of S. 1888 may be included in S. 442 before a bill reaches the Senate floor.)

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<sup>3</sup>The amended version of H.R. 3849 reported by the Judiciary Committee on June 17, 1998, dropped entire sections of the bill reported by the Commerce Committee, but did not otherwise make changes in the bill language.

For further details on the chronology of the bills, see the section **Congressional Action on the Bills** at the end of this report.

As explained above, the general approach taken in all the bills is to place a moratorium on the ability of state and local governments to impose certain taxes on the Internet and related activities. During the moratorium period, state and local governments would be prohibited or preempted from levying the taxes specified in the particular bill. The moratorium is intended to provide time for an appointed group to study the issues and make recommendations regarding taxation and regulation of the Internet. The justification for congressional intervention, expressed in the findings section of S. 442, is Congress's authority over interstate and foreign commerce, as provided by the Commerce Clause of the United States Constitution (article I, section 8, clause 3).

### Points of Difference

Apart from agreement on the above points, there are significant differences among the bills on such basic issues as:

- the length of the moratorium;
- which aspects of the Internet are to be protected from taxation;
- which types of taxes would be prohibited and which permitted;
- whether existing taxes would be grandfathered;
- the focus of the consultative group or commission;
- membership of the consultative group;
- whether the issue of collecting taxes on out-of-state sales will be addressed;
- whether other telecommunications issues will be addressed; and
- what policy actions are expected at the end of the moratorium.

**Length of the moratorium.** In the original bills, the moratorium was indefinite. Under H.R. 1054, it could last 8 years. Under H.R. 3529, H.R. 3529 (Judiciary substitute), H.R. 3849 (Commerce), and H.R. 4105 as passed by the House, it would last 3 years from the date of enactment. Under S. 442, the moratorium would last until January 1, 2004 (more than 5 years). Under S. 1888, it would last until December 31, 2001 (more than 3 years).

**What aspects of the Internet would be protected from taxation?** All of the bills would prohibit state and local taxation of *Internet access* and online services, such as America Online's or Erol's monthly access charge.<sup>4</sup> H.R. 3849 (Commerce), H.R. 3529 (Judiciary substitute), and H.R. 4105 would exempt from the moratorium taxes on Internet services offered as part of a bundled package of services, only if the service provider separates the billing for services other than Internet access or online services.

H.R. 3529, H.R. 3529 (Judiciary substitute), H.R. 3849, and H.R. 4105 also would prohibit *bit taxes* (on the volume of digital information transmitted over the Internet) and *multiple or discriminatory taxes on electronic commerce*. All these bills

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<sup>4</sup>H.R. 3529 (Judiciary substitute) and H.R. 4105 dropped explicit reference to online services in the list of prohibited taxes, but refer to them in the definition of Internet access.

would prohibit sales and use taxes where the use of a computer server is used to determine nexus or agent status for a remote seller (included in the definition of discriminatory taxes). H.R. 3529 (Chabot) also would prohibit *bandwidth taxes* (on the capacity to transmit data over the Internet).<sup>5</sup>

Under H.R. 3529, H.R. 3529 (Judiciary substitute), H.R. 3849, and H.R. 4105, the prohibition against discriminatory taxation would prevent state and local governments from taxing products or services that are delivered uniquely over the Internet, in electronic form only. Under all the Internet bills (House and Senate), transactions arranged over the Internet but delivered separately in tangible form would be treated like mail order or telephone sales. This means that for most interstate sales arranged over the Internet, sellers could not be required to collect sales and use taxes from the customer.

With respect to the taxation of activities conducted over the Internet, H.R. 1054 would also prohibit taxes on the transmission or communication, and use or consumption, of data acquired through the Internet or online services. S. 442 would prohibit taxes on communications or transactions using the Internet.

S. 1888 would broadly prohibit taxes directly or indirectly on the use of the Internet or Internet-related services, as the original versions of H.R. 1054 and S. 442 did. Because this prohibition could be interpreted so broadly, these three bills specifically exempt from the moratorium a list of types of taxes commonly applied to businesses.

**Moratorium only on new taxes, or existing taxes as well?** H.R. 1054, S. 442, and S. 1888 would place the moratorium (on the types of taxes enumerated in the bill) on existing as well as new taxes. H.R. 3529 attempted to place the moratorium only on new taxes. An issue was that the bill language of the original H.R. 3529 (Chabot) exempted existing taxes on Internet access or online services only if they have been implemented by state statute. The 12 states now taxing Internet access have done so by applying existing taxes<sup>6</sup> through rulings or other decisions made by state revenue departments, and not by statutory action.

Addressing this issue, H.R. 3849 (Commerce) exempted from the moratorium taxes on Internet access or online services "generally imposed and actually enforced" under state law before March 1, 1998. For the tax to remain enforceable, however, a state would need to enact a law expressly imposing such a tax within one year from the date of enactment of H.R. 3849. Concern was expressed at the House Commerce Committee markup that existing local taxes, if any, were not grandfathered as well.

H.R. 3529 (Judiciary substitute) and H.R. 4105 as passed by the House exempt from the moratorium the taxes on Internet access in effect on the date of enactment in 8 states enumerated in the bill — if, within one year from enactment of this federal

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<sup>5</sup>No bit or bandwidth taxes have yet been imposed in the United States. They have been discussed in Europe.

<sup>6</sup>These are typically state sales taxes on telecommunications services or on information or data-processing services.

legislation, the state enacts a law affirming that it imposes such a tax on Internet access. The bill would not grandfather local taxes, including taxes levied by the District of Columbia.<sup>7</sup>

**Focus of the consultative group or commission.** H.R. 1054 and S. 442 would establish a single consultative group and broadly direct it to study domestic (state and local) and international taxation of the Internet and make recommendations to the President. The group is not expected to draft proposed federal or state law. H.R. 1054 goes into a far more detailed description than S. 442 of what topics should be addressed in the study and recommendations.

H.R. 3529 (Chabot) would establish two groups: a consultative group to examine international tax policy toward the Internet, and a separate commission on electronic commerce. The commission on electronic commerce would focus on the application of sales and use taxes to remote commerce. The commission is expected to develop proposed legislation to submit to Congress regarding expanded authority for states to require vendors to collect use taxes on out of state sales.

H.R. 3849 (Commerce) would create a single advisory commission on electronic commerce. The commission is expected to develop proposed legislation to submit to Congress regarding expanded authority for states to require vendors to collect use taxes on out of state sales. Unlike H.R. 3529 which refers to all remote sellers, for committee jurisdictional reasons H.R. 3849 focuses the proposed legislation on sales conducted using the Internet. H.R. 3849 separately assigns the Secretary of Commerce the task of examining barriers in foreign markets to U.S. businesses engaged in electronic commerce or U.S. providers of telecommunications services.

H.R. 3529 (Judiciary substitute) would create an advisory commission on electronic commerce. As under H.R. 3529 (Chabot) and H.R. 3849 (Commerce), the commission is expected to develop proposed legislation to submit to Congress regarding expanded authority for states to require remote sellers to collect use taxes on out of state sales. The Judiciary Committee separately approved an amended version of H.R. 3849 that retained the abovementioned provision for the Secretary of Commerce to examine barriers in foreign markets to U.S. electronic commerce or telecommunications services.

Like H.R. 3849, H.R. 4105 as passed by the House both establishes an advisory commission on electronic commerce and directs the Secretary of Commerce to study and prepare a report on foreign electronic commerce. Like H.R. 3529, H.R. 4105 would have the advisory commission examine, and propose federal legislation on, sales and use taxation of all remote sales, whether arranged by the Internet or other by means such as mail order or telephone.

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<sup>7</sup>The 8 grandfathered states are Connecticut, Wisconsin, Iowa, North Dakota, South Dakota, New Mexico, Tennessee, and Ohio. The Governors of South Carolina and Texas reportedly voluntarily withdrew their states from the exemption. The Judiciary Committee approved an amendment that eliminated the exemption for the District of Columbia and certain named home-rule cities in Colorado that had been included in their original substitute language.

S. 1888 would create a commission on Internet taxation and regulation focused on developing model legislation for a uniform commercial code for the Internet. It would remain up to each state to adopt the model legislation. The commission is also to study the effect of current federal statutes and regulations on the Internet and recommend appropriate modifications, and to identify any inconsistencies in state and local taxation and regulation of the Internet and Internet-related services.

**Membership of the consultative group or commission.** There is some difference among the bills about which cabinet secretaries would be members of the commission. There is also a difference in the number of members, the method of selecting the representatives state and local government interests and business interests, and the selection of the chair.

All of the bills name the Secretaries of Treasury and Commerce as members of the consultative groups or commissions. H.R. 1054 and S. 442 also include the Secretary of State. H.R. 3529 (Chabot) includes the Secretary of State in the consultative group to study international tax policy toward electronic commerce, but not in the (domestic) commission on electronic commerce. Like H.R. 3529 (Judiciary substitute), H.R. 4105 as passed by the House includes the Attorney General with the Secretaries of Treasury and Commerce on the advisory commission on electronic commerce. Like H.R. 3849 (Commerce), H.R. 4105 gives the Secretary of Commerce, and not the Secretary of State, the responsibility for studying foreign electronic commerce.

H.R. 1054 and S. 442 name as members of the consultative group two organizations that are already independently working on these issues: the National Tax Association (NTA)-sponsored Joint Communications and Electronic Commerce Tax Project, and the American Bar Association (ABA)-sponsored National Conference of Commissioners of Uniform State Laws (NCCUSL). H.R. 4105, like H.R. 3529 and H.R. 3529 (Judiciary substitute), indicates that its advisory commission is to consult with the NTA project. S. 1888 does not mention either group.

H.R. 1054 and S. 442 make only general reference to having the cabinet secretaries consult with representatives of consumer and business groups, states and political subdivisions thereof, and other appropriate groups. The bills introduced in the spring of 1998 give much more specific instruction on the membership of the group to study state and local policies. H.R. 3529's commission on electronic commerce would have 29 members including:

- the Secretaries of Treasury, Commerce, and State;
- 14 representatives of state and local governments, including 2 representatives each from 7 named state and local organizations;
- 12 representatives of consumers and business, 2 each appointed by the President and the 5 congressional leaders (Senate majority leader, the Senate minority leader, the Speaker of the House, the House majority leader, and the House minority leader).

The chair would be appointed upon joint recommendation of the 4 party leaders, based on nominations from the National Governors' Association.



H.R. 3849's (Commerce) temporary Advisory Commission on Electronic Commerce would be composed of 29 members, including:

- the Secretaries of Commerce and Treasury, or their respective representatives;
- 14 representatives from state, local, and county governments, comprised of 2 representatives each from 6 named state and local government organizations, and 1 representative each from 2 other organizations;
- 13 representatives of taxpayers and business, 3 appointed by the President, and 2 each by the 5 congressional leaders.

Two of the members would be named as co-chairpersons. One chairperson would be a representative selected by the National Governors' Association from one of the state and local interest group representatives. The other would be selected jointly by the Speaker of the House and the Senate majority leader from the taxpayer-business group. Although 15 members constitute a quorum, 18 members (a supermajority) would need to approve the proposed legislation. The commission would sunset when the last of the committees of jurisdiction concludes consideration of the proposed legislation, or 3 years after the date of enactment, whichever occurs first.

H.R. 4105 adopts the provisions of H.R. 3529 (Judiciary substitute). Under H.R. 4105 as passed by the House, the temporary Advisory Commission on Electronic Commerce would have 31 members including:

- 3 representatives from the federal government:  
the Attorney General,  
the Secretary of Commerce, and  
the Secretary of Treasury, or their respective representatives;
- 14 representatives from state, local, and county governments:  
2 each from:  
the National Governors' Association  
the National Conference of State Legislatures  
the Council of State Governments  
the National Association of Counties  
the National League of Cities  
the United States Conference of Mayors;  
1 each from:  
the International City/County Managers Association  
the American Legislative Exchange Council);
- 14 representatives of taxpayers and business, 7 appointed by the majority (jointly by the Speaker of the House and the majority leader of the Senate) and 7 by the minority (jointly by the minority leader of the House and the minority leader of the Senate) leadership of the Congress. (The President would not make any of the appointments.) Within each group of 7, there should be  
3 engaged in providing Internet access, or communications or transactions that use the Internet;  
3 engaged in electronic commerce, including at least 1 in mail order commerce; and  
1 engaged in software publishing.

The chair would be selected from among the membership. Sixteen members would constitute a quorum, but 19 members (a supermajority) would be needed to approve the proposed legislation. The commission would sunset when the last of the committees of jurisdiction concludes consideration of the proposed legislation, or 3 years after the date of enactment, whichever occurs first.

S. 1888's commission on Internet taxation and regulation would have 15 members including:

- the Secretaries of Treasury, Commerce, and State;
- 3 Governors (including one from a state that does not impose a sales tax);
- 3 chief executive officers of a political subdivision of a state (including one from a subdivision that does not impose a sales tax);
- 3 individuals employed by or affiliated with companies engaged in computer manufacturing activities, software activities, or activities related to the Internet or the provision of Internet-related services; and
- 3 individuals employed by or affiliated with companies engaged in electronic commerce (including at least one who is employed by or affiliated with a company engaged in mail order commerce).

The chair and vice-chair would be selected from among the membership. A majority of the members would constitute a quorum, but 10 (a supermajority) would need to approve the model legislation.

**Staffing and funding the commission.** S. 1888 is the only one of the bills to explicitly authorize staff, compensation, and travel expenses for the commission. Other bills permit the commission to receive grants and gifts and to borrow resources from the agencies whose cabinet secretaries are named to the commission, and use the facilities of those agencies for meetings.

**International taxation and tariffs.** With the exceptions of H.R. 3529 (Judiciary substitute), all of the bills state that the President should seek bilateral and multilateral agreements, through certain named international organizations,<sup>9</sup> to establish that commercial activity on the Internet is free from tariffs and taxation. H.R. 4105, like H.R. 3849, adds a concern for freedom from undue and discriminatory regulation for Internet access and online services, and from discriminatory regulation and discriminatory taxation (in contrast to the reference to all taxation found in the other bills) of electronic commerce in the international arena.

H.R. 1054 and S. 442 instruct their consultative group to study international as well as domestic taxation of the Internet. H.R. 3529 (Chabot) establishes a separate consultative group to focus exclusively on the international taxation of electronic commerce. H.R. 3849 and H.R. 4105 assign the Secretary of Commerce the task of examining barriers in foreign markets to U.S. businesses engaged in electronic

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<sup>9</sup>H.R. 4105 and H.R. 3849 add the International Telecommunications Union and the Free Trade Area of the Americas to the list of organizations found in the other bills: the World Trade Organization, the Organization for Economic Cooperation and Development, the Asia Pacific Economic Cooperation Council, or other appropriate international fora.

commerce or U.S. providers of telecommunications services. S. 1888 does not list international taxation as a topic for its commission on regulation and taxation to study.

For jurisdictional reasons, H.R. 3529 (Judiciary substitute) does not mention the study of international issues, except for having the advisory commission examine the collection and administration of consumption taxes on remote commerce in other countries and the United States. However, the Judiciary Committee separately approved an amended version of H.R. 3849, which preserves the provision for the Secretary of Commerce to examine barriers in foreign markets and the declaration regarding international treatment of the Internet. H.R. 4105 as passed by the House includes these two foreign provisions from H.R. 3849.

**Federal taxation.** The review of federal taxation of the Internet is not a point of emphasis in any of the bills. H.R. 1054 and S. 442 refer to studying domestic taxation of the Internet, but they do not specifically mention federal taxes. H.R. 3529 recommends that there be no federal taxation of the Internet and does not assign the subject of federal taxation for evaluation. S. 1888 recommends no federal, state, or local taxation of the Internet; although taxation is in the name of the commission on regulation and taxation, it is not enumerated as an area to be studied. H.R. 3849 refers to identifying taxes, fees, and charges on electronic commerce in the U.S. but does not specifically mention federal taxes. H.R. 3529 (Judiciary substitute) and H.R. 4105 do not mention studying federal taxes.

**FCC and telecommunications issues.** H.R. 4105 includes provisions from H.R. 3849 (Commerce) specifically addressing telecommunications issues. H.R. 4105, like H.R. 3849, would prevent both the Federal Communications Commission (FCC) and state commissions from regulating the prices or charges paid by subscribers for Internet access or online services. The FCC also would be prevented from imposing regulatory fees on such services. However, the FCC and state commissions would not be prevented from otherwise implementing the 1996 Telecommunications Act or from regulating telecommunications carriers that offer Internet access or online services bundled with other telecommunications services.

FCC issues and the telecommunications services industry are included in the instructions for all 3 studies mandated by H.R. 3849 and H.R. 4105. The existing National Telecommunications and Information Administration is asked to determine whether any direct or indirect federal regulatory fees are imposed on Internet providers and make recommendations to Congress regarding whether such fees should be modified or eliminated. The Advisory Commission on Electronic Commerce (that would be created by the bill) is asked to examine ways to simplify state and local taxes imposed on the provision of telecommunications services. U.S. providers of telecommunications services are specifically mentioned among the topics for the Secretary of Commerce to examine with respect to barriers in foreign markets.

H.R. 3529 (Judiciary substitute), drafted in recognition of the jurisdictional conflict with the Commerce Committee includes a few items acknowledging the telecommunications and FCC regulatory fee concerns of the Commerce Committee. In addition, the Judiciary Committee reported an amended version of H.R. 3849 which preserves the abovementioned sections relating to FCC and telecommunications concerns. H.R. 4105 adopted those provisions.

S. 442 would exempt from the moratorium taxes imposed on or collected by a common carrier or by a provider of telecommunications services. The term tax is defined to include any license or fee imposed by a governmental entity. The Senate bills do not otherwise explicitly address FCC or telecommunications services issues.

**Timetable for recommendations and actions.** Under H.R. 1054, the Secretary of the Treasury has 4 years from enactment to submit a final report and recommendations. The Congress is then given 4 years to consider the recommendations submitted by the President. There is no time limit on the President to transmit recommendations to Congress, and no requirement for Congress to act. It is not clear whether the moratorium would go on indefinitely if the President submitted no recommendations, or sunset if the Congress took no action upon the President's recommendations.

Under S. 442, the consultative group would have 18 months from enactment to submit policy recommendations to the President. The President would have 2 years from enactment (another 6 months) to transmit recommendations to Congress. The moratorium would not expire for another 4 years (January 1, 2004). Congress is not required to take any action.

Under S. 1888, the commission has until December 31, 2000 (approximately 2 years), to submit its report, a year before the end of the moratorium (December 31, 2001). No time or other requirements are set on the President or the Congress to act on the commission's recommendations.

Under H.R. 4105 passed by the House, as under H.R. 3529 (Chabot and Judiciary substitute) and H.R. 3849 (Commerce), the commission would have 2 years from enactment to develop and transmit proposed legislation. This is 1 year before the end of the moratorium. The President is given a 45-day review period. The Congress is given 90 days from the commission's submission to take some action as described under the expedited procedure provisions of each bill.

**What policy actions are expected at the end of the moratorium?** It is not clear what policy actions any of the bills expect at the end of the moratorium. All of the bills require that a consultative group conduct a study and make recommendations to the President. H.R. 1054, S. 442, and H.R. 3529 (Chabot) require the President, in turn, to submit recommendations to the Congress. The others — H.R. 4105 as passed, H.R. 3529 (Judiciary substitute), H.R. 3849, and S. 1888 — permit their commissions to submit recommendations directly to the Congress as well as to the President.

None of the bills requires Congress to take action regarding the recommendations submitted by the President or the commission. However, the spring 1998 House bills include two different forms of expedited congressional procedure for the proposed federal legislation to be submitted by the commission on electronic commerce regarding collection of interstate sales taxes.

H.R. 3529 (Chabot) provides that the commission submit its proposed legislation directly to Congress at the end of a 45-day presidential review period. After 90 legislative days the respective committees would automatically be discharged from considering the legislation, and it would be placed on the floor calendar of each

chamber. This provision would make it impossible for committees formally to prevent floor consideration of the legislation, but would not ensure that either house would actually proceed to consider it. H.R. 3529 does not specify how the legislation would be formally introduced and referred after being transmitted to Congress in draft.

Like H.R. 3849 (Commerce) and H.R. 3529 (Judiciary substitute), H.R. 4105 provides that not later than 90 legislative days after its transmission to Congress the proposed legislation shall be considered by the respective committees of jurisdiction in the House and Senate, and, if reported, referred to the proper calendar on the floor of each House for final action. Unlike H.R. 3529 (Chabot), H.R. 4105 as passed by the House provides no guarantee that the proposed legislation will be forwarded from the committees for floor consideration. The committees would retain control over the content of any bill that might be forwarded.

## Reactions to the Proposals

### Arguments For and Against a Moratorium

Supporters of a federally imposed moratorium want to forestall new efforts by state and local governments to tax the Internet and business conducted over the Internet and, where possible, prohibit existing taxes on the Internet and Internet access. Some supporters are committed to using the moratorium period to develop nationwide standards for state and local taxation of the Internet with reasonable compliance procedures. Others view the temporary moratorium as setting a precedent for a permanent prohibition on Internet taxation.

Opponents are concerned that if the moratorium lasts a long time, the Internet industry will be substantially larger and able to lobby even more strongly than today against being subject to taxes. Opponents are also concerned that having once endorsed a moratorium on certain taxes, Congress would be reluctant to permit those taxes to be imposed in the future and might make the moratorium permanent.

Opponents view the concern about Internet taxation as mostly a prospective one. Although a few examples of aggressive taxation were cited at congressional hearings, to date most state and local governments have refrained from imposing taxes on the Internet. Currently only 12 states tax Internet access. No state or local governments levy bit taxes. CBO could not identify any current state or local taxes that would clearly meet the definition in H.R. 3849 (Commerce) of multiple or discriminatory taxes on electronic commerce.<sup>9</sup>

State and local representatives generally opposed the initial versions of H.R. 1054 and S. 442, and oppose S. 1888. They object to the idea of a federally imposed moratorium. Instead, they support an effort already begun by the National Tax

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<sup>9</sup>Congressional Budget Office Mandates Statement, reprinted in: U.S. Congress. House. Committee on Commerce. *Internet Tax Freedom Act*. Report together with Additional Views to accompany H.R. 3849. 105<sup>th</sup> Cong., 2d Sess., Report 105-570, Part I, June 5, 1998. Washington, 1998. p. 19.

Association's (NTA) Communications and Electronic Commerce Project to reach a voluntary government-industry agreement and develop technical guidelines for a consistent and administratively simplified policy for state and local sales and use taxation of interstate sales. They are concerned that a moratorium would reduce the industry's incentive to participate in the effort to reach an agreement on tax policy. But supporters of the moratorium are concerned that haphazard taxes would proliferate during the many years it could take for the NTA group to reach an agreement and then to get the states to adopt and implement those policies.

### Collecting Out-of-State Sales Taxes

**Nexus rules.** For many years, the states have been looking to Congress for help in collecting sales and use taxes due on out-of-state mail order sales. Under the current legal interpretation of nexus rules, a seller is required to collect and remit sales taxes only on behalf of the jurisdiction in which it has a "physical presence."<sup>10</sup> Thus, a retailer is responsible for collecting and remitting sales taxes only to the jurisdiction(s) in which it is physically located (the state and possibly the county or city, if it levies a sales tax). This tax collection rule applies to mail-order or telephone vendors as well as store-front retailers.<sup>11</sup>

If a sale is made and delivered to a purchaser in another state, the seller is not obligated to collect a sales tax on the transaction. Technically, under state law, it remains the purchaser's obligation to remit a parallel "use" tax to his home jurisdiction, equivalent to the sales tax that would be due if the purchase had been made in the home state. In practice, however, it is difficult for governments to enforce and collect use taxes from individual purchasers; businesses purchasers are more likely to comply. States would like Congress to change the nexus rules regarding interstate sales so that more sellers (large sellers in particular) could be required to collect the use tax from the customer at the time of the purchase and then remit the revenues to the customer's home state.

It is because of these current nexus restrictions that state and local governments found little consolation in the proposed exemption from the moratorium for sales or use taxes found in the early versions of H.R. 1054, S. 442, and S. 1888. These three bills make no effort to reconsider the nexus rules governing tax collection on remote (interstate) sales made by mail order or over the Internet. The exemption from the moratorium proposed in those bills would apply to sales or use taxes on sales or other transactions effected over the Internet — but only if they are levied in the same way, and on the same person or entity, as in the case of sales or transactions effected by mail order, telephone, or other remote means within its taxing jurisdiction. Thus, as with mail-order sales, states would not be able to require Internet vendors to collect and remit use taxes on out-of-state sales.

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<sup>10</sup>See CRS Report 92-487, *Quill v. North Dakota: The Mail Order Tax Case*, by Thomas B. Ripy.

<sup>11</sup>For example, if a mail-order purchase is being made from a vendor located solely in California, the instructions on the order form are likely to indicate, "Residents of California, add 6.0% sales tax." Residents of other states do not need to include any payment for a sales or use tax.

**The states want Congress's help.** State and local officials are more willing to support a bill like H.R. 3529 (Chabot and Judiciary substitute), H.R. 3849 (Commerce), or H.R. 4105 as passed by the House. These bills include provisions not found in the original bills, reflecting the compromise reached with state Governors in March 1998 on addressing out-of-state sales tax collection issues. These bills would create a temporary commission on electronic commerce and direct it to examine certain topics and develop proposed federal legislation including specified elements. The legislation to be proposed could authorize a state to impose on remote sellers the duty to collect sales or use tax from the customer and remit the revenue to the purchaser's home state. However, the duty of sellers to collect would apply if, and only if, the state had adopted a single, combined state and local sales and use tax rate for remote commerce, as well as other simplified procedures for the administration of its sales and use tax.<sup>12</sup>

For committee jurisdictional reasons, under H.R. 3849 (Commerce), the term remote seller is restricted to a person selling interstate using the Internet. Under H.R. 3529 (Chabot and Judiciary substitute) and H.R. 4105, a remote seller includes any person selling from one state to a purchaser in another state, without regard to the method of sale. Thus, under H.R. 4105 as passed by the House, the proposed obligation for the seller to collect and remit taxes would apply to mail order sales as well as sales arranged over the Internet. The term "mail order" is used here in a general sense that encompasses catalog sales, and sales arranged by telephone or fax, as well as by mail.

A remaining question is whether there should be a difference in the sales tax treatment of:

- communications or transactions transmitted entirely over the Internet (e.g., products, services, information, or data delivered in electronic form);
- versus
- transactions arranged over the Internet, but delivered separately in physical form (the Internet-equivalent of mail-order or telephone sales of tangible items).

Under H.R. 4105's definition of discriminatory taxation, during the moratorium, products or services delivered uniquely over the Internet could not be taxed at all. Sales arranged over the Internet but delivered separately in physical form would be treated like mail order or telephone sales. This means that sales and use taxes could not be collected on interstate transactions of goods arranged over the Internet (unless the out-of-state vendor also had a physical presence in the buyer's state), but states could require Internet vendors to collect sales taxes on within-state sales.

**Simplifying compliance for sellers.** The world of mail-order, telephone, fax, and now Internet sales has opened up the possibility that even a small business may be selling to customers anywhere in the United States or, for that matter, anywhere in the

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<sup>12</sup>The streamlined interstate sales tax collection proposal within these Internet tax bills partly reflects ideas advanced in several Congresses by Senator Dale Bumpers, most recently as S. 1586, the Consumer and Main Street Protection Act of 1998, introduced on January 29, 1998. S. 1586 focuses on mail-order sales and does not address electronic commerce.

world. Even the states are willing to admit the potential legal complexity and high administrative costs facing an entity that conducts business in numerous state, let alone local, taxing jurisdictions. In the interest of reducing tax compliance costs, voluntary membership organizations like the Multistate Tax Commission (MTC) and the American Bar Association's National Conference of Commissioners on Uniform State Laws (NCCUSL) have long been working toward the goal of getting the states and their local jurisdictions to adopt more nationally uniform definitions in their tax codes. But state and local governments have often resisted cooperating with these uniformity efforts in the interest of maintaining their independence in setting tax policy.

Simplifying the process of state, and especially local, tax collection and remittance was part of the sales tax proposal advanced by the National Governors' Association and is included in the instructions that H.R. 3529 (Chabot and Judiciary substitute), H.R. 3849 (Commerce), and H.R. 4105 give to the commission drafting proposed federal legislation. Remote sellers would not be expected to administer the sales taxes of individual local jurisdictions.

To benefit from any expanded nexus rules proposed by the commission, each state could choose its own combined state-local sales tax rate, but that rate would have to apply uniformly for all local jurisdictions throughout the state. (A state without sales taxes could choose a zero rate.) In addition, a state would need to agree to certain streamlined procedures for the administration of its sales and use taxes, including uniform registration, tax returns, remittance requirements, and filing procedures. States which did not adopt a single tax rate and simplified administrative procedures within four years of enactment would be considered to have a zero sales tax rate on remote commerce.

H.R. 3529 (Chabot and Judiciary substitute), H.R. 3849 (Commerce), and H.R. 4105 instruct the commission to examine a method of distributing an appropriate share of the revenues to individual local governments within a state. The commission is also to examine the possibility of using an independent third-party tax-collection system (so that sellers could remit taxes to a single collection entity that would be responsible for forwarding the revenues to the appropriate state, and possible local, government). The commission is also expected to recommend criteria for establishing sufficient nexus for imposing the duty to collect taxes on the seller.

## Unfunded Mandate

The Congressional Budget Office has reviewed several versions of the Internet tax bills and concluded the federal preemption of state and local governments' ability to levy certain taxes, without offsetting federal compensation, would be an intergovernmental mandate.<sup>13</sup> Consequently, under the terms of the Unfunded

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<sup>13</sup> CBO has prepared a mandates statement on S. 442 as introduced and as ordered reported by the full committee, H.R. 1054 as approved by the subcommittee, and H.R. 3849 as approved by the full committee. Because of ambiguities, CBO could not in all cases determine whether the \$50 million threshold for an intergovernmental mandate was exceeded. U.S. Congress. House. Committee on Commerce. *Internet Tax Freedom Act*. Report



Mandates Reform Act of 1995 (UMRA, P.L. 104-3, U.S.C. 1501-1571), a point of order could be raised against the Internet Tax Freedom bill when it comes to the floor for a vote.<sup>14</sup>

### Ambiguity of Bill Language

It has proven difficult to draft bill language that expresses the intent of the legislation in a simple yet legally unambiguous way.<sup>15</sup> There has been a particular problem with enumerating the taxes which would be exempt from the moratorium under H.R. 1054, S. 442, and S. 1888. The stated intent of the sponsors was that the moratorium would prohibit discriminatory taxes on the Internet, but permit the taxes typically paid by other types of businesses. The problem is that with so many possible state and local tax structures, the list of exempted taxes under H.R. 1054 and S. 442 has grown long and may still be insufficient to accomplish the bills' intent. In its mandates statement evaluating the November 4, 1997 version of S. 442, the Congressional Budget Office (CBO) noted that it was unclear how the criteria in the bill regarding exemptions would apply to the state and local taxes that are currently levied on Internet-related transactions or services. CBO anticipated that this was likely to be the subject of litigation.<sup>16</sup>

### Congressional Action on the Bills

This section summarizes congressional activity on each of the several bills introduced in the 105<sup>th</sup> Congress addressing state and local taxation of the Internet. H.R. 1054, H.R. 3529, H.R. 3849, H.R. 4105, and S. 442 are all called the Internet

<sup>13</sup>(...continued)

together with Additional Views to accompany H.R. 3849. 105<sup>th</sup> Cong., 2d Sess., Report 105-570, Part I, June 5, 1998. Washington, 1998. p. 16-19.

<sup>14</sup>For an explanation of congressional procedures required under UMRA, see CRS Report 97-238. *Unfunded Mandates Reform Act of 1995*, by Sandra Osbourn, January 24, 1997. pp. 2-7. See also, U.S. Congressional Budget Office. *An Assessment of the Unfunded Mandates Reform Act in 1997*. February 1998. Box 1. Available through the CBO Home Page at <http://www.cbo.gov>.

<sup>15</sup>For detailed examples of ambiguities and possible unintended consequences in the bill language, see Maserov, Michael and Iris J. Lav. *A Federal "Moratorium" on Internet Commerce Taxes Would Erode State and Local Revenues and Shift Burdens to Lower-Income Households*. Washington, Center on Budget and Policy Priorities, May 11, 1998. <http://www.cbpp.org/512webtax.htm>.

<sup>16</sup>U.S. Congressional Budget Office. S. 442: Internet Tax Freedom Act. Mandates Statement, as ordered reported by the Senate Committee on Commerce, Science, and Transportation on November 4, 1997. Washington, Jan. 21, 1998. At issue, in particular, are existing sales, use, or other transaction taxes on Internet access and online services and on information and data processing services. The question is whether the taxes are also imposed and collected in the case of "similar sales, uses, or transactions not using the Internet, online services, or Internet access service," in which case they would be exempt from the moratorium.

**Tax Freedom Act.** S. 1888 is called the Internet Fairness and Interstate Responsibility Act (Net FAIR Act). Although all of the bills would place a moratorium on state and local taxation of the Internet, the bills differ in many specific respects (discussed in the section **Contents of the Bills**).

In brief, the original companion bills, H.R. 1054 and S. 442, were introduced in March 1997. Subsequently, both were revised in response to criticisms by state and local government organizations. In the spring of 1998, in the House, two new bills were introduced in place of H.R. 1054: H.R. 3529 in the House Judiciary Committee and H.R. 3849 in the House Commerce Committee. Each bill incorporated a version of the proposal advanced by the National Governors' Association in February 1998: before the end of the moratorium, a study commission would propose legislation to Congress to help a state require out-of-state vendors to collect sales and use taxes—if the state simplifies its state and local tax administration procedures. H.R. 3849 also addressed telecommunications issues and regulation of the Internet.

The Commerce Committee reported H.R. 3849 on May 14, 1998. On June 17, 1998, the Judiciary Committee adopted an amendment in the nature of a substitute to H.R. 3529. Challenging the jurisdiction of the Commerce Committee over interstate tax matters, the Judiciary Committee also approved an amendment to H.R. 3849 which removed the Commerce Committee provisions relating to the tax moratorium and the advisory commission on electronic commerce. The Judiciary Committee reported both bills as amended, H.R. 3529 and H.R. 3849, on June 17.

On June 22, Representative Cox introduced H.R. 4105. This new consensus bill combined elements from H.R. 3529 and H.R. 3849. H.R. 4105 was brought to the House floor under a suspension of the rules and was approved by voice vote on June 23.

In the Senate, the version of S. 442 approved by the Senate Commerce Committee in November 1997 continues to be revised before being brought to the Senate floor. S. 1888 was introduced in May 1998 in objection to some of the revisions made to the original S. 442. Portions of S. 1888 may be included in the revised S. 442.

In the remainder of this section, the bills are discussed in chronological order of their introduction within each house.

## **House of Representatives**

**H.R. 1054 (Cox).** Internet Tax Freedom Act. H.R. 1054 was introduced on March 13, 1997, as a companion bill to S. 442. The original bill included a section (dropped from subsequent versions of H.R. 1054) that would ban the regulation of Internet prices by the Federal Communications Commission (FCC). Because of that provision, the bill was referred to the House Committee on Commerce, in addition to the Committee on the Judiciary. A hearing on H.R. 1054 was held by the House Commerce Committee, Subcommittee on Telecommunications, Trade, and Consumer Protection, on July 11, 1997. The House Judiciary Committee, Subcommittee on Commercial and Administrative Law, held a hearing on July 17, 1997.

State and local interest groups objected to H.R. 1054 and S. 442, particularly to the language describing which taxes would be subject to the moratorium and which would be exempt. On October 9, 1997, revised versions of H.R. 1054 bill were approved by two House subcommittees: the Telecommunications, Trade, and Consumer Protection Subcommittee of the House Commerce Committee and the Commercial and Administrative Law Subcommittee of the House Judiciary Committee.

H.R. 1054 did not receive further consideration. Instead, the full House Commerce Committee reported H.R. 3849 on May 14, 1998. The full House Judiciary Committee substantially amended and reported H.R. 3529 and H.R. 3849 on June 17, 1998.

**H.R. 3529 (Chabot).** Internet Tax Freedom Act. H.R. 3529 was introduced March 23, 1998, and referred to the Committee on the Judiciary. H.R. 3529 was also referred to the House Ways and Means Committee (because of provisions regarding the study of international taxation) and the Committee on Rules (because of provisions regarding expedited congressional procedure of legislation to be proposed under the bill). Unlike H.R. 1054 and H.R. 3849, H.R. 3529 was not referred to the Committee on Commerce.

H.R. 3529 represents a compromise with the National Governors' Association. It includes a proposal for a commission to develop federal legislation to require remote (out-of-state) sellers to collect sales taxes and remit them to the home state of the purchaser, in exchange for a state's simplifying the administration of its sales tax. The tax proposed collection requirement would apply to sales arranged by mail order and telephone as well as over the Internet.

**H.R. 3529 (Judiciary Committee substitute for Chabot bill).** Internet Tax Freedom Act of 1998. On June 17, 1998, the House Judiciary Committee adopted an amendment in the nature of a substitute to H.R. 3529, previously introduced in that committee by Representative Chabot. The Committee approved one amendment that eliminated the proposed grandfathering of taxes on Internet access by certain local governments in Oregon and the District of Columbia. In an effort to develop a consensus bill, the substitute bill drew upon elements of several bills: H.R. 3529, H.R. 3849, and S. 1888. The Judiciary Committee substitute for H.R. 3529 addresses a few of the concerns related to taxation of telecommunications and Federal Communications Commission (FCC) fees that were raised by the Commerce Committee in H.R. 3849. It also raises special concerns about small sellers in the examination of sales taxation of remote commerce. It was expected that the bill would be revised further and considered in conjunction with the Judiciary Committee amendment to H.R. 3849 (see below).

**H.R. 3849 (Cox and White/Commerce Committee).** Internet Tax Freedom Act. H.R. 3849 was introduced May 12, 1998, and referred jointly to four committees: Commerce, Ways and Means, the Judiciary, and Rules. It was approved unanimously by the Commerce Committee by a vote of 41-0, with one technical amendment, on May 14, 1998.

Like H.R. 3529, H.R. 3849 represents a compromise with the National Governors' Association. It includes the proposal for a commission to develop federal

legislation to require remote (out-of-state) sellers to collect sales taxes and remit them to the home state of the purchaser, in exchange for a state's simplifying the administration of its sales tax. Under H.R. 3849, however, any nexus changes for remote sellers in the proposed legislation would apply only to sales arranged over the Internet, and not by mail order or other means. H.R. 3849 differs from the other bills in including provisions related to telecommunications and emphasizing freedom from regulation for the Internet.

**H.R. 3849 (Judiciary Committee amendment to Commerce Committee bill).** The Judiciary Committee challenged the jurisdiction of the Commerce Committee over matters related to state taxation of interstate commerce. On June 17, 1998, the Judiciary Committee, by voice vote, adopted and reported an amendment to H.R. 3849 which removed from the bill approved by the Commerce Committee the sections related to the tax moratorium and related definitions, the creation of the advisory commission on electronic commerce, and the recommendations for the commission's research agenda and legislative proposal. It left the sections relating Federal Communications Commission issues; the report on foreign commerce to be prepared by the Secretary of Commerce; the Congress's position on minimizing international regulations, tariffs, and discriminatory taxation; and expedited congressional consideration for the legislation to be proposed by the advisory commission. It was expected that the amended version of H.R. 3849 would be considered in conjunction with the substitute amendment for H.R. 3529 (also reported by the Judiciary Committee on June 17) to develop a comprehensive consensus bill.

**H.R. 4105 (Cox). Internet Tax Freedom Act.** H.R. 4105 is the consensus bill passed by the House. It drew upon elements from H.R. 3529 and H.R. 3849, both as amended by the Judiciary Committee, and from H.R. 3849 as originally approved by the Commerce Committee. H.R. 4105 was introduced on June 22. The bill was considered so non-controversial that it was brought to the House floor under a suspension of the rules and was approved by voice vote, without dissent, on June 23.

H.R. 4105 includes concerns of the Commerce Committee, included in H.R. 3849, about Federal Communications Commission regulations and fees not applying to the Internet, and about foreign commerce, together with the tax moratorium, the creation of the advisory commission on electronic commerce, and the recommendations for the commission's research agenda and legislative proposal endorsed by the Judiciary Committee in H.R. 3529. The House-passed bill retains the compromise included in H.R. 3529 and H.R. 3849 between House supporters of a tax moratorium and state and local interest groups' concerns about having Congress consider the issue of interstate sales and use taxation of mail order sales and sales arranged over the Internet, narrowing the definition of the taxes subject to the moratorium, and grandfathering existing taxes.<sup>17</sup>

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<sup>17</sup> For a summary of the bill, see CRS Report 98-xxx, *Internet Tax Freedom Act: H.R. 4105 as Passed by the House*, by Nonna A. Noto.

## Senate

**S. 442 (Wyden).** Internet Tax Freedom Act. S. 442 was introduced on March 13, 1997, as a companion bill to H.R. 1054. It was referred to the Senate Committee on Commerce, Science, and Transportation. The Communications Subcommittee held a hearing on May 22, 1997. The bill was subsequently revised in response to objections by state and local interest groups. A revised bill was approved by the full Commerce Committee on November 4, 1997. Reportedly, more revisions have been made to the bill since November. The new bill language was not officially available as of this writing. It is expected that an amended version of S. 442 will be brought to the Senate floor.

**S. 1888 (Gregg and Lieberman).** Internet Fairness and Interstate Responsibility Act (Net FAIR Act). S. 1888 was introduced March 31, 1998. Although the bill was officially referred to the Committee on Commerce, Science, and Transportation, it is unlikely to be considered by that committee, which has already approved S. 442. Some parts of S. 1888 may be incorporated into the amended version of S. 442 before a bill is brought to the Senate floor.

S. 1888's description of the moratorium is similar to the original March 1997 bill language of H.R. 1054 and S. 442. S. 1888 does not address the issue of interstate sales. The bill downplays the development of standards for international and state and local taxation. In place of a consultative group on tax policy, S. 1888 substitutes a proposal to establish a commission to develop a uniform commercial code for the Internet (a uniform set of definitions and principles for state and local jurisdictions to utilize regarding regulation and taxation of commercial transactions on the Internet). The bill addresses detailed operational matters for the commission, such as compensation rates, staff, and powers to require information.

## Congressional Hearings, Reports, and Documents

- U.S. Congress. House. Committee on Commerce. Subcommittee on Telecommunications, Trade, and Consumer Protection. *The Internet Tax Freedom Act*. Hearing on H.R. 1054. 105th Cong., 1st Sess., Serial No. 105-33, July 11, 1997. Washington, U.S. Govt. Print. Off., 1997.
- U.S. Congress. House. Committee on Commerce. *Internet Tax Freedom Act*. Report together with Additional Views to accompany H.R. 3849. 105<sup>th</sup> Cong., 2d Sess., Report 105-570, Part I, June 5, 1998. Washington, 1998.
- U.S. Congress. House. Committee on the Judiciary. Subcommittee on Commercial and Administrative Law. *Internet Tax Freedom Act*. Hearing on H.R. 1054. 105<sup>th</sup> Cong., 1<sup>st</sup> Sess., Serial No. 25, July 17, 1997. Washington, U.S. Govt. Print. Off., 1997.
- U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Subcommittee on Communications. *S. 442, The Internet Tax Freedom Act*. Hearing. 105<sup>th</sup> Cong., 1<sup>st</sup> Sess., S.Hrg. 105-435, May 22, 1997. Washington, U.S. Govt. Print. Off., 1998.

## For Additional Reading

- Bonnett, Thomas W. *Is the New Global Economy Leaving State-Local Tax Structures Behind?* Washington, National League of Cities, National Conference of State Legislatures, and National Governors' Association, 1998.
- Maserov, Michael and Iris J. Lav. *A Federal "Moratorium" on Internet Commerce Taxes Would Erode State and Local Revenues and Shift Burdens to Lower-Income Households*. Washington, Center on Budget and Policy Priorities, May 11, 1998. <http://www.cbpp.org/512webtax.htm>. Also published as: Problems with a 'Moratorium' on Internet Commerce Taxation. Special Report. *Tax Notes*, v. 79, no. 10, June 8, 1998. p. 1327-54.
- U.S. Congressional Budget Office. *An Assessment of the Unfunded Mandates Reform Act in 1997*. February 1998. Available through the CBO Home Page at <http://www.cbo.gov>.
- S. 442: Internet Tax Freedom Act. Mandates Statement, as ordered reported by the Senate Committee on Commerce, Science, and Transportation on November 4, 1997. Washington, January 21, 1998.

## CRS Reports

- CRS Report 98-597. *Internet Tax Freedom Act: H.R. 4105 as Passed by the House*, by Nonna A. Noto.

**NATIONAL  
GOVERNORS  
ASSOCIATION**



## News Release

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**FOR IMMEDIATE RELEASE**

July 16, 1998

Contact: Becky Fleischer, 202/624-5364

### **GOVERNORS DECLARE SENATE FINANCE BILL 'THE WRONG DIRECTION' FOR AMERICA—*"Pro-Internet Legislation for the 21<sup>st</sup> Century Marketplace Requires a Thoughtful, Reasoned Approach"***

Washington, D.C.—National Governors' Association (NGA) Executive Director Raymond C. Scheppach called the Senate Finance committee Internet bill "the wrong direction for America's 21<sup>st</sup> Century marketplace." Testifying before the Senate Finance committee, Scheppach outlined the governors' position for achieving a fair, efficient electronic marketplace for the twenty-first century.

Governors continue to support a three-year moratorium on specifically defined new Internet taxes and a commission of business and state and local representatives to study an updated, streamlined sales tax system that ensures equitable tax treatment for all businesses and consumers. The bill passed by the House is much closer to achieving these goals with a shorter, three-year moratorium targeted toward new taxes on Internet access and discriminatory and multiple taxes. Governors aim to simultaneously encourage the growth of the Internet while preserving the states' abilities to provide critical services to their citizens.

The multiple and protean bills moving through the Senate are unacceptable to governors. "Unfortunately all the Senate bills demonstrate a complete disregard for the inevitable legal debacles that would be sparked by poorly written legislation. The broadly defined language in the Senate bills couldn't possibly address fifty different state tax codes, each thousands of pages long, without creating giant tax loopholes and mammoth legal challenges. Taxpayers should not be forced to pick up the tab for this lack of foresight," said Scheppach.

Governors believe that federal legislation should not create double standards and special tax loopholes at the expense of Main Street and other taxpayers. Such loopholes will sap funds for critical services provided by state and local governments, such as crime prevention, health care, and education.

"There is zero evidence that state and local governments are targeting the Internet for new and increased taxes," said Scheppach. "In fact, many states have reduced or eliminated taxes on Internet business or Internet access. Since 1997, Connecticut, Florida, Georgia, Massachusetts, and Washington have passed laws removing taxes from the Internet. New York reduced taxes on the Internet through an executive order. As it is currently drafted, the Senate Finance committee bill represents chicken little policy at the expense of Main Street business and other taxpayers."

Governors support legislation that would provide a three-year moratorium or "time out" to address the complexities of a new technologically driven marketplace, and a commission bringing together business, consumers, and federal, state and local governments to develop consensus legislation that promotes business growth and tax fairness. The structure of the House bill fits these criteria with seven technical amendments. The House bill represents a bipartisan, thoughtful effort to develop legislation to meet the needs of the electronic commerce of the future, bringing together industry, governors and members of Congress to develop consensus.

"Governors urge the Senate to recognize the dangers of passing poorly defined, unnecessary legislation. We hope the Senate follows the House lead by adopting the House-passed bill with some technical amendments. Negotiating with business and state and local leaders develops good legislation that prepares our nation for twenty-first century commerce. The House bill reflects this constructive consensus-building," said Scheppach.

—END—



July 30, 1998

Hon. William Roth  
 Chairman  
 Finance Committee  
 United States Senate  
 Washington, DC

Re: Hearings on S. 442, Internet Tax Freedom Act

Dear Chairman Roth:

**Software  
 Publishers  
 Association**

On behalf of the Internet Tax Fairness Coalition and the Software Publishers Association, thank you for the opportunity to testify before your committee during its recent hearing on the tax and trade aspects of the Internet Tax Freedom Act, S. 442 and H.R. 1105.

During the hearing, you asked me whether I was aware of any companies that had been deterred from using the Internet because of complexity and ambiguity of states sales taxation. I responded that while I was unaware of any specific company that had been so deterred, I was aware of survey by the international accounting firm of KPMG Peat Marwick of corporate executives' attitudes on the subject which concluded that state sales and use tax complexity was a deterrent. I offered to provide you with a copy of that study. I am happy to report that I have located a copy of the study and have enclosed the same with this letter. I ask that you make this study a part of the record of the proceedings.

One of the purposes of this study was to determine to what extent ambiguity about the imposition of state sales and transactions taxes impede the growth of electronic commerce. The survey showed that 7 of 10 executives stated that state and local taxes laws governing electronic commerce were ambiguous and that slightly more than half of those polled said that the lack of clarity inhibited their involvement with Internet business applications.

Again, on behalf of the Coalition and SPA, I thank you for the opportunity to appear before your committee.

Respectfully submitted,

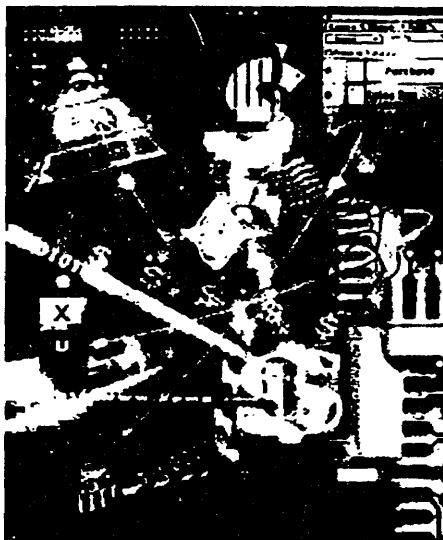
Mark E. Neber  
 Vice President and Counsel  
 Software Publishers Association

Cc: Members of the Committee  
 Brig Pari  
 Nicholas Giordano





The Global Leader



## **Electronic Commerce: Taxation Without Clarification**

**A Study of Senior Financial Executives' Attitudes and  
Concerns About Tax Policies and Trends Affecting the  
Internet**

**Prepared by:  
Patricia E. Neil  
KPMG Peat Marwick LLP  
Sales and Transactions Tax Practice  
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## **Background and Objectives**

The growing number of consumers accessing the Internet's cornucopia of information, product and service offerings is now in the millions and continues to grow daily. The use of "the net" as an instantaneously accessible global shopping mall is beginning to attract the marketing interest of virtually any company with something to sell. There is a critical need to better understand the business opportunities and problems associated with this new technology.

KPMG Peat Marwick LLP, an international professional services firm that provides a wide range of value-added consulting, assurance and tax services in more than 130 countries, observed the steady uptilt in growth of electronic commerce and was interested to learn more about how the marketplace at-large perceives the potential profits and pitfalls of this emerging business technology.

In an effort to take the pulse of executive interest and concern about the Internet's economic possibilities, KPMG conducted a study among 291 companies with gross revenues in excess of \$50 million. In-depth telephone interviews were conducted with 392 financial executives from four different industry groups – publishing, software/business services/advertising, communications, and manufacturing/distribution/retail during the month of June. KPMG was particularly

interested to learn more about the executive's perceptions of the following aspects of buying or selling products and services over the Internet:

- What is the level of current and anticipated growth in Internet commerce, from both purchasing and sales perspectives?
- What is the importance of Internet commerce today and over the next two to five years?
- What is the profile of the most proactive participants in Internet business transactions?
- How do industries differ in their degree of current or anticipated interest in conducting purchasing or sales activities over the Internet?
- Does participation, interest or lack of interest in Internet business vary by industry type or revenue level?
- Are executives' familiar with the sales and transactions tax implications of electronic commerce?

- **To what extent does the ambiguity about the imposition of such taxes impede the growth of electronic commerce?**
- **What, if anything, are companies doing to influence or better understand the tax laws and regulations affecting electronic commerce?**

## EXECUTIVE SUMMARY OF FINDINGS

### Electronic Commerce As An Economic Force

Financial executives from a variety of major U.S. companies widely believe that Internet or electronic commerce will become a major economic force in American industry within the next two to five years. In fact, 83% of executives from companies currently engaged in commercial enterprise on the Internet believe that the Internet can potentially become a major vehicle for U.S. exports in the next few years. Altogether, 6 out of 10 companies interviewed are currently engaged in business on the Internet, either as buyers, sellers or both.

A noteworthy 8 out of 10 companies are either engaged or *planning* to engage in electronic commerce in the next two to five years. As might be expected, communications companies and those who categorize themselves as software/business service companies lead the pack. Electronic commerce is least popular among firms engaged in manufacturing, distribution or retail activities. According to 9 out of 10 executives, outdated and unclear tax schemes may stymie the growth of electronic commerce unless government steps in to clarify the rules.

### Level of Urgency

Interestingly, the importance of doing business on the Internet *today* is rated relatively low with only 20% of respondents indicating that electronic commerce is extremely or very important at this time. More than 50% say that electronic commerce will grow very important within the next two years and that number surpasses 70% within the next 5 years.

### Impediments to Growth: Tax Ambiguities

Nearly 7 out of 10 executives stated that state and local tax laws governing electronic commerce are ambiguous. It is not surprising that slightly more than half of those polled say that this lack of clarity is inhibiting their involvement with Internet business applications. Even top financial officers say they are not at all familiar with the sales and transactions tax implications of electronic commerce. Significantly from a compliance standpoint, the study revealed that:

- Fewer than 1 out of 2 respondents are aware that their companies' electronic commerce activities may be subject to sales or transactions tax;

- Fewer than 1 out of 3 are aware that their companies may be subject to federally levied taxes such as excise, income or environmental taxes:
- Very few are aware of recent attempts by other countries to levy electronic commerce taxes, including the few of those who are already engaged in international transactions on the Internet.

### Need for Clarity

Agreement that government needs to clarify the tax situation was nearly unanimous with 9 out of 10 respondents calling for regulations written in understandable terms. However companies' active participation in seeking swift government action is extremely low – less than one-third. The limited efforts to influence future tax policies for Internet commerce has so far been restricted to industry group discussions. Perhaps most revealing of the confusion and frustration surrounding electronic tax issues was that apart from their discussions with colleagues, senior financial executives say they have done little or nothing to understand the tax implications that may be involved. Twenty percent admitted that they do not know whether their companies are even subject to sales and transactions taxes on the sale of products and services over the Internet. Half, however, claim that they intend to participate in industry discussions and debates in the future.

**Reasons Cited for Concern About Tax Regulation**

On the other side of the call for clearer guidelines, 4 out of 10 companies surveyed and 2 out of 3 communications companies surveyed, expressed concern about introducing or rewriting the laws that govern sales and transactions taxes affecting electronic commerce. Specific concerns included: privacy, diminished competitiveness, fairness, classifying jurisdictional authority, record keeping/compliance and administrative costs. (Note however that these are some of the same reasons others cited for rewriting the laws.)

On the subject of international competitiveness, about one-third of the respondents believe that state and local taxes imposed on electronic commerce will diminish their ability to compete, and, in fact, a number said they would consider moving their Internet activities offshore to escape imposition of state and local taxes.



## **METHODOLOGY**

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In order to explore issues relevant to Internet commerce among major U.S. companies, a sample of CFOs and tax directors of firms with sales of \$50 million dollars or more was selected to participate in a telephone. A total of 392 interviews were conducted in the following four major industry groups:

- Communications
- Publishing
- Software/business services/advertising
- Manufacturing/distribution/retail

The survey was conducted for KPMG Peat Marwick LLP by Clark, Martire & Bartolomeo, Inc. Interviewing was conducted between June 11-28, 1996. This study carries a sampling error of plus or minus 5% for total results and plus or minus 5.5% for firms currently conducting electronic commerce or planning to in the next two years, firms particularly relevant to the survey's objectives.

For more information on KPMG's study *Electronic Commerce: Taxation Without Clarification*, or on our State and Local Tax services, please contact :

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 NATIONAL CONFERENCE OF STATE LEGISLATURES
 

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RICHARD H. FINAN  
 PRESIDENT OF THE SENATE  
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 PRESIDENT NCSL

ANNE C. WALKER  
 CHIEF CLERK ADMINISTRATOR  
 MISSOURI HOUSE  
 STAFF CHAIR, NCSL

WILLIAM POLYB  
 EXECUTIVE DIRECTOR

July 16, 1998

Honorable William Roth  
 United States Senate  
 Washington, D.C. 20510

Dear Chairman Roth:

I write to you on behalf of the National Conference of State Legislatures (NCSL) to express our support for H.R. 4105, the Internet Tax Freedom Act, as passed by the House of Representatives last month. We also are supportive of certain technical corrections to the definitions of taxes and we believe these changes will not be controversial.

I understand the time constraints that the Senate Finance Committee has with regard to this legislation and the reason for such short notice on this hearing. I appreciate the invitation you extended to NCSL, however, I am sorry I am not able to join you this morning. I respectfully request that this letter be placed into the Committee's Hearing Record.

As you are aware, NCSL is the bipartisan national organization representing every state legislator from all 50 states, our nation's commonwealths, territories and possessions. At the annual Spring Meeting of NCSL's membership in April 1998, my colleagues and I unanimously approved a resolution, which stipulated our conditions for supporting Congressional legislation on Internet taxation. Briefly, our resolution stated that we would support legislation, which would:

- Provide for a "time-out" or moratorium of no more than three years on new or discriminatory taxes on the Internet to allow federal, state and local government officials as well as electronic commerce based businesses the opportunity to address the complexities of a new technologically driven marketplace;
- Provide for specific definitions of the taxes to be included under the moratorium so as to avoid costly and time consuming legal challenges to existing state and local taxes;
- Protect the revenues of the those states that presently enforce and collect a tax on services such as Internet access; and
- Provide for a commission of federal, state and local officials as well as business and consumer representatives to develop consensus legislation that promotes business growth and tax fairness for all commerce, regardless of how the sales transactions may occur.

These principles are embodied in H.R. 4105, the Internet Tax Freedom Act, as passed by the House. These principles also represent the outcome of difficult negotiations between the

House sponsor of the legislation, Congressman Christopher Cox of California, the representatives of the national organizations of elected state and local officials, the Internet industry as well as the Direct Marketers Association.

While NCSL has endorsed the overall direction of H.R. 4105, we are concerned about the precedent of requiring states to reaffirm existing state tax law. We also are concerned with the lack of protection for local government taxes during the moratorium, particularly Home Rule communities empowered through state constitutions and statutes.

We are aware that there are other bills under consideration in the Senate, S.442 by Senator Wyden and S. 1888 by Senators Gregg and Lieberman. While we were not opposed to the version of S. 442 as reported from the Senate Commerce Committee, we believe that H.R. 4105 provides a better foundation for state and local governments as well as the private sector to achieve the goals of a coordinated and simplified tax structure that will not be an impediment to the growth of the Internet and other electronic services.

With regard to S. 1888 by Senators Gregg and Lieberman, we must make clear our opposition to this legislation. We believe that it would be a major step backward from the positive direction that we have achieved in our negotiations with both the Internet industry and representative of the Direct Marketers. We also are very dismayed with the proposed government members of the commission, three governors and three mayors, no state legislators. As I am sure you can agree, executive branch officials should not be the sole determiners of tax policy.

My colleagues and I recognize that the vital economic force that the Internet and advanced communications systems will be for our states and our nation. We also recognize that there is a need for a coordinated and simplified tax structure for all commercial transactions. We believe that the House passed version of the Internet Tax Freedom Act, H.R.4105, is a positive step in providing a foundation for state and local governments as well as the private sector to achieve these goals.

We commend you, Mr. Chairman, and Senator Moynihan for your willingness to hold this hearing, as well as the sponsor of the original Internet Tax Freedom Act, Senator Ron Wyden, for his responsiveness to many state and local concerns on Internet taxation. While we believe that H.R. 4105 is a positive step, we look forward to working with you to enact a bill, which does not subject the Internet industry to multiple or discriminatory taxes and does not preempt the sovereign rights of states to determine their own tax policies.

Sincerely,



Myra Jones  
Representative - State of Arkansas  
Chair, NCSL Commerce and Communications Committee

