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Extending the Internet Tax Moratorium and Related Issues

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Summary

The Internet Tax Freedom Act, enacted in 1998, placed a 3-year moratorium on the ability of state and local governments 1) to impose new taxes on Internet access or 2) to impose multiple or discriminatory taxes on electronic commerce. It grandfathered existing taxes on Internet access. The original moratorium expired on October 21, 2001. Numerous bills to extend the moratorium were introduced in the first session of the 107th Congress. The Congress approved H.R. 1552 (P.L. 107-75, enacted November 28, 2001) which extended the prior moratorium by 2 years, until November 1, 2003.

The bills under active consideration during 2001 addressed two major sets of issues. The first centered on how long to extend the moratorium and whether to continue to grandfather existing taxes on Internet access. The second addressed the simplification of state and local sales and use tax systems and whether Congress was willing to signal support for the states' effort to have out-of-state sellers collect taxes on interstate sales. (Tax simplification is treated as a prerequisite to Congress granting states the authority to require tax collection by remote sellers.)

The two issues were linked. Some supporters of granting the states sales and use tax collection authority wanted no extension of the moratorium. Others wanted the extension to be long enough for the states to accomplish meaningful sales tax simplification, but not so long that public perception of the Internet as a tax-free shopping zone could become entrenched. They preferred a shorter extension of the moratorium – of 2 years or less. They might have agreed to a longer extension if sales tax collection provisions were included in the extension bill. Those skeptical of the ability of state and local governments to quickly agree upon and implement meaningful sales tax simplification favored a longer extension – of 4 or 5 years. Those who opposed addressing the issue of tax collection by remote sellers typically favored a longer, if not permanent, extension of the moratorium.

The moratorium extension bill that was enacted, H.R. 1552 (P.L. 107-75), did not address the sales and use tax simplification and collection issue. However, before voting to approve H.R. 1552 as received from the House, the Senate debated the Enzi-Dorgan amendment (S.Amdt. 2155), which did address the issue in considerable detail. The amendment was tabled by a vote of 57 to 43. Still, both during the debate and after the votes in the Senate, several Senators expressed their intention to pursue an agreement on the sales and use tax simplification and collection issues raised in the amendment during the added 2 years of the moratorium.

Two other issues related to definitions in the Internet Tax Freedom Act were of particular concern to state and local revenue officials. One was including otherwise taxable products and services in the definition of tax-protected Internet access. Another was businesses using Internet kiosks and dot-com subsidiaries to avoid sales tax collection and other tax obligations, based on the definition of discriminatory tax. This report will not be updated.

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Extending the Internet Tax Moratorium and Related Issues

Introduction

The moratorium imposed by the Internet Tax Freedom Act¹ (ITFA) in 1998 prohibited state and local governments from levying 1) new taxes on “Internet access” and 2) any “multiple or discriminatory taxes on electronic commerce.” The Act grandfathered taxes on Internet access that were in place prior to October 1, 1998, thereby permitting existing access taxes to continue. The initial moratorium expired on October 21, 2001. The 107th Congress approved H.R. 1552 (P.L. 107-75, enacted November 28, 2001), extending the prior moratorium by 2 years, until November 1, 2003, and continuing to grandfather existing taxes on Internet access.

Numerous bills were introduced in the first session of the 107th Congress to extend the moratorium. Several bills addressed other issues related to state and local taxation of the Internet and interstate commerce.²

The main questions with regard to extending the moratorium were:

- how long to extend the moratorium – several months, 2 years, 4 or 5 years, or permanently;
- whether to extend the moratorium on Internet access taxes permanently, but extend the moratorium on multiple and discriminatory taxes temporarily; and
- whether to continue to grandfather existing taxes on Internet access.

A major issue raised in conjunction with extending the moratorium was:

- whether Congress would consider granting states the authority to require remote sellers to collect sales and use taxes on interstate sales and, if so, under what conditions.

Before voting on H.R. 1552, the Senate debated the Enzi-Dorgan amendment to H.R. 1552 (S.Amdt. 2155), which addressed the sales and use tax collection issue in considerable detail. The amendment was tabled by a vote of 57 to 43. However, both during the debate and after the votes in the Senate, several Senators expressed

¹The Internet Tax Freedom Act comprises Titles XI and XII of Division C of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (H.R. 4328, P.L. 105-277, 112 Stat. 2681), enacted October 21, 1998.

²For a side-by-side comparison and brief description of the individual bills introduced and a summary of congressional action, see CRS Report RL31158, *Internet Tax Bills in the 107th Congress: A Brief Comparison*, by Nonna A. Noto.

their intention to continue to pursue an agreement on the sales tax simplification and collection issues raised in the Enzi-Dorgan amendment.³

Under each subheading that follows is a short description and pro-con analysis of the issue. References are made to specific bills introduced during 2001 that took a position on the particular issue.⁴ Many of the same issues remain to be addressed when the expiration of the Internet tax moratorium approaches again, in 2003. The discussion is organized in two parts. The first focuses on the moratorium, including definitions in the Internet Tax Freedom Act. The second addresses issues related to collecting sales and use taxes on interstate sales.

Moratorium Issues

The main issues with regard to extending the moratorium were how long to extend it and whether to continue to grandfather existing taxes on Internet access. However, state and local revenue officials were also concerned about other issues related to definitions in the Internet Tax Freedom Act. The definition of Internet access may be interpreted as being broad enough to exempt products and services sold together with Internet access that might otherwise be taxable, if treated independently. With respect to discriminatory taxes, one issue is states having to treat Internet sales like mail-order sales for sales and use tax collection purposes. Another issue is businesses using Internet kiosks and dot-com subsidiaries to avoid sales tax collection and other tax obligations.

How Long to Extend the Moratorium

The first issue differentiating the Internet tax bills introduced in 2001, during the first session of the 107th Congress, was how long to extend the prior 3-year moratorium, which expired on October 21, 2001. The moratorium has two components. The first prohibits state or local governments from imposing new taxes on “Internet access.” The second prohibits them from imposing any “multiple or discriminatory taxes on electronic commerce.”

Among the bills introduced, some would have extended both parts of the moratorium temporarily – ranging from 8 months (S. 1504) up to 2 years (H.R. 1552/P.L. 107-75 and S. 1481), 4 years (H.R. 1410/S. 512), or 5 years (S. 246 and S. 1525). Four bills would have made the moratorium on Internet access taxes permanent, but extended the moratorium on multiple and discriminatory taxes temporarily, by 4 (S. 1542, S. 1567, and S.Amdt. 2155) or 5 years (S. 288). Four other bills would have made both parts of the moratorium permanent (H.R. 1675/S. 777, H.R. 2526, and S. 589). The bill that was enacted, H.R. 1552 (P.L. 107-75),

³*Congressional Record*, Daily Edition, vol. 147, Nov. 15, 2001; floor debate, S11902-15; text of S.Amdt. 2155, S11963-64.

⁴For a similar analysis of bills introduced in the 106th Congress, see CRS Report RL30667, *Internet Tax Legislation: Distinguishing Issues*, by Nonna A. Noto.

extended both parts of the moratorium by 2 years and a few days, until November 1, 2003.

No Extension. Some opposed any extension of the Internet tax moratorium. This group included those who fundamentally object to federal restrictions on state and local taxing authority. It also included those who felt that the original moratorium was largely anticipatory in the sense that not many states were levying or intending to levy the prohibited taxes, and that there was not likely to be a rush to impose such taxes if the moratorium ended.

Opponents also included those who did not want the moratorium extended unless Congress addressed the issue of sales and use taxation of interstate commerce at the same time. They were concerned that unless Congress strongly signaled its support for taxing Internet commerce like “bricks and mortar” commerce in the near future, businesses would aggressively pursue methods of business organization and Internet technology designed to avoid state and local tax liability, exacerbating an existing problem (see the discussion of “Internet Kiosks” below).

Temporary Extension. Many of those concerned with eventually addressing the sales and use tax collection issue were willing to simply extend the prior moratorium temporarily, but not for too many years. They wanted any extension of the moratorium to be long enough for the states to accomplish meaningful sales tax simplification, but not so long that the Internet access and electronic commerce industries could grow large and powerful enough to stop any attempt to tax them, or that public perception of the Internet as a tax-free shopping zone could become entrenched. From this vantage point, a 4- or 5-year extension of the moratorium seemed too long. A shorter extension of 2 years or less was preferable.⁵

Permanent Extension. Supporters of permanently extending the moratorium included those specifically opposed to taxing any activity that occurs over the Internet (both Internet access and electronic commerce), as well as those generally opposed to any tax. Supporters of a permanent extension of the moratorium on multiple and discriminatory taxes were typically not interested in addressing the taxation of interstate sales.

Some of the bills would have permanently extended the moratorium on Internet access taxes, but temporarily extended the moratorium on multiple and discriminatory taxes on electronic commerce for 4 or 5 years. This dichotomy reflected substantial differences in the views of these two parts of the moratorium, discussed in more detail in the sections that follow.

⁵The link between the length of the moratorium extension and the sales tax collection issue is discussed further in the subsection below on “Connection to Extending the Moratorium” in the section on “Collecting Use Taxes on Interstate Internet Sales.”

New Internet Access Taxes

The Internet Tax Freedom Act placed a moratorium on state and local governments' ability to impose new taxes on Internet access, but grandfathered existing taxes on Internet access that were in place prior to October 1, 1998.

Definition of Internet Access. The taxation of Internet access refers to applying state and local taxes to the monthly charge that subscribers pay for access to the Internet through Internet service providers (ISPs). When applied, the tax on Internet access is most commonly a retail general sales tax, but may also take the form of other transactional taxes such as telecommunications, gross receipts, or business and occupation taxes (see the discussion below of "States with Grandfathered Taxes"). Among those states that do levy a sales tax on Internet access, the state sales tax rate ranges from 4% to 6.25%.

According to Section 1104(5) of the Internet Tax Freedom Act, "The term 'Internet access' means a service that enables users to access content, information, electronic mail, or other services offered over the Internet and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services." The breadth of this definition gives rise to the issue of including, in the definition of Internet access, products and services that might otherwise be taxable (discussed further in the subsection below on "Bundling of services").

In addition to basic access to the Internet, an ISP subscription typically includes basic services offered over the Internet, such as access to electronic mail (e-mail) and a standard browser (Internet Explorer or Netscape Navigator). The subscription may also include access to some proprietary information services. Internet access subscriptions can differ substantially in the services they offer, the limit on the number of access hours covered under the standard fee, and their price. As of fall 2001, monthly subscription charges ranged from free, \$5, or \$10 for limited basic services; to \$18 to \$24 for unlimited enhanced services such as those offered by America Online (AOL), Microsoft Network (MSN), or EarthLink; and up to \$30 to \$50 for high-speed Internet access, also known as broadband.⁶

Arguments For Extending Moratorium on Access Taxes. Supporters of extending the moratorium on new Internet access taxes, and of removing the grandfathering protection for existing taxes, argued that taxing Internet access would raise the price of the service, thereby discouraging the spread of the new technology and the growth of electronic commerce. They also argued that access taxes would widen the digital divide between those who can afford access to the new technology and those who cannot.⁷ Some also argued that access taxes are, in part, double

⁶High-speed Internet access or broadband service is provided by Cable-TV services, by telephone companies through digital subscriber lines (DSL), and by satellite companies. Explanation and price survey from "You've got...choices" [for Internet access], *Consumer Reports*, September 2001, 12-15.

⁷For arguments on both sides of this and other Internet tax issues, see Advisory Commission (continued...)

taxation if ISPs are also paying taxes on the underlying “backbone transmission” telecommunications service used to provide Internet access.

The effort to ban Internet access taxes also can be viewed as part of the movement to simplify or eliminate state and local telecommunications taxes and to repeal the federal telephone excise tax. The “majority” on the Advisory Commission on Electronic Commerce had proposed, among other items, a permanent moratorium on Internet access taxes, simplifying state and local telecommunications taxes (in addition to simplifying sales taxes), and repealing the 3% federal telephone excise tax.⁸ These proposals were included in various bills introduced in the 106th Congress.⁹

Arguments Against Extending Moratorium on Access Taxes. Others opposed extending the moratorium on new Internet access taxes and removing the grandfathering protection for existing access taxes. They especially opposed a permanent extension of the ban. They also opposed an extension of the ban with Internet access defined as it currently is in the Internet Tax Freedom Act (reported above under “Definition of Internet Access”), because of the “bundling of services” issue (discussed in the next subsection).

States generally oppose federal efforts to restrict their taxing authority. States also want to retain the flexibility to adapt their tax structure to the rapidly changing telecommunications landscape. There is concern, even within the communications industry, that the tax burden on different modes of communication be comparable. This objective suggests that as long as other modes such as telephone (which is also used to fax) and cable are subject to state and local taxes, the Internet should also be taxed, so as not to grant the Internet a competitive pricing advantage. Opponents of the moratorium refuted the double-taxation argument (explained in the previous subsection on “Arguments for Extending Moratorium on Access Taxes”) by pointing out that Internet service providers could be able to claim a sale-for-resale exemption for the taxes they pay on the underlying telecommunications services.¹⁰

⁷(...continued)

on Electronic Commerce, *Issues and Policy Options Paper*, Final draft submitted to the Advisory Commission from the Report Drafting Subcommittee, Arlington, Virginia, December 3, 1999, Section II, Tax Treatment of Internet Access, 6-7. The text of the *Issues and Policy Options Paper* is available on the website of the Advisory Commission on Electronic Commerce [<http://www.ecommercecommission.org>].

⁸The text of the Advisory Commission on Electronic Commerce’s *Report to Congress* is available on their website [<http://www.ecommercecommission.org>]. The report was presented to Congress on April 12, 2000.

⁹See CRS Report RL30412, *Internet Taxation: Bills in the 106th Congress*, by Nonna A. Noto, and CRS Report RS20119, *The Telephone Excise Tax: Revenues, Effects, and Repeal Proposals*, by Louis Alan Talley.

¹⁰In H.R. 4105 (the version of the Internet Tax Freedom Act passed by the House in the 105th Congress, on June 23, 1998) the prohibition of multiple taxation included applying a telecommunications tax to Internet access if a tax was also imposed on the underlying telecommunications services used to provide Internet access without allowing a credit for other taxes paid, a sale for resale exemption, or other mechanism for eliminating duplicate taxation.

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Bundling of services. Typically, when taxable products or services are sold “bundled” together with non-taxable products or services for a single price, the entire package is taxable, unless the price of the nontaxable portion is stated separately. If Internet access were defined more narrowly than it currently is, the issue would be how to state the price of the basic Internet access services in the tax-protected portion of the service package, separately from the price of the enhanced services in the taxable portion.¹¹

Instead, the issue here is the breadth of the definition of Internet access. States were concerned that the existing definition in the Internet Tax Freedom Act might be interpreted as being broad enough to exempt from tax not only basic Internet services, such as the ability to connect to and surf the Internet and use e-mail but also a range of other services and products sold together with Internet access that might be taxable if purchased on their own. Some examples would be information services, cable television, books, magazines, games, music, and movies offered online.

Increasingly, basic connection to the Internet is being sold together with a variety of other products and services, by the same vendor, for a single fee. Many of the additional products and services could arguably fit under the ITFA’s definition of Internet access. If they did, then state and local governments stand to lose substantial tax revenue on the sale of products and services that might otherwise be subject to state and local telecommunications, sales, or franchise taxes, if they were treated independently.

Consequently, if the ban on Internet access taxes was to continue, some state and local governments were concerned that the definition of Internet access be narrowed. S. 1542, S. 1567, and S.Amdt. 2155 would have added to the ITFA a definition of Internet access services that excluded the receipt of content or ancillary services.¹² (S. 1542 and S. 1567, but not S.Amdt. 2155, also would have amended the definition of Internet access to include wireless web access services, while continuing to exclude telecommunications services generally.)

The bill enacted, H.R. 1552 (P.L. 107-75), simply extended the prior moratorium on new Internet access taxes for 2 years, until November 1, 2003. It did not make any changes to the definitions contained in the original Internet Tax Freedom Act.

¹⁰(...continued)

That provision was not included in the version of the ITFA enacted in October 1998.

¹¹H.R. 4105 (the version of the Internet Tax Freedom Act passed by the House in the 105th Congress, on June 23, 1998) would have protected bundled Internet access services from taxation only if the service provider separately stated the portion of the billing that applied to the Internet access services. That provision was not included in the version of the ITFA enacted in October 1998.

¹²An alternative to trying to define tax-protected Internet access more narrowly would be exempting from tax a dollar amount sufficient to cover the cost of basic Internet access service. (For example, Texas exempts up to \$25 of a monthly Internet access bill.) Charges in excess of such a threshold could be subject to applicable taxes, if the states chose to tax enhanced services.

Grandfathering for Existing Internet Access Taxes

A second area of difference among the bills to extend the Internet tax moratorium was whether to continue the grandfathering protection provided by the Internet Tax Freedom Act, for state and local taxes on Internet access that were already in place at the time of the law's enactment in October 1998. Removing the grandfathering protection would, in effect, ban all state and local taxes on Internet access.

Half of the bills that proposed to permanently ban Internet access taxes would have explicitly removed the grandfathering protection for existing taxes through specific language (H.R. 1675/S. 777, H.R. 2526, and S. 288). The other half would have preserved the grandfathering. S. 589 would have implicitly extended the grandfathering by simply extending the prior moratorium permanently. S. 1542, S. 1567, and S.Amdt. 2155 would have explicitly continued the grandfathering. In contrast, the bills to temporarily extend the prior moratorium on Internet access taxes all would have implicitly extended the grandfathering provision for existing Internet access taxes (H.R. 1410/S. 512, H.R. 1552/P.L. 107-75, S. 246, S. 1481, S. 1504, and S. 1525).

The bill enacted, H.R. 1552 (P.L. 107-75), implicitly extended the grandfathering of existing Internet access taxes by simply extending the prior moratorium for 2 years, until November 1, 2003.

States with Grandfathered Taxes. As of October 2001, 10 states had taxes on Internet access. Eight states levy their regular retail sales tax (or other transactional tax) on Internet access: Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, and Wisconsin. Washington levies a business and occupation tax in the form of a gross receipts tax. New Hampshire applies a telecommunications services tax to two-way communications provided by certain types of entities; this includes Internet access provided by certain cable TV companies.

Some states that once levied a tax on Internet access have voluntarily chosen to reduce or eliminate their tax.¹³

¹³For example, the Connecticut retail sales tax on Internet access was repealed, effective July 1, 2001, following a 4-year phase-out that began on July 1, 1997. State of Connecticut, Department of Revenue Services, *Taxation of Internet Access Provided by Community Antenna Television Companies*, Policy Statement PS 2001(8), July 2, 2001. Available online from Tax Analysts [<http://www.taxbase.tax.org>], Document No. Doc 2001-20167, Electronic Citation 2001 STT 147-3.

“Iowa eliminated the sales tax on Internet access in 1999, after the Department of Revenue and Finance began to make serious efforts to collect the tax.” Jack Hunt, Iowa Unlikely to Restore Tax on Internet Access, *State Tax Notes*, October 31, 2001, available online from Tax Analysts, Doc. No. Doc 2001-27462, Electronic Citation 2001 STT 212-8.

South Carolina decided not to enforce collection of sales and use taxes with respect to
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Removing Grandfathering An Unfunded Mandate. In the 106th Congress, H.R. 3709, the Internet Nondiscrimination Act of 2000, which was approved by the House on May 10, 2000, proposed a 5-year extension of the initial moratorium and elimination of the grandfathering protection for existing taxes on Internet access. In its cost analysis of H.R. 3709, the Congressional Budget Office (CBO) determined that eliminating the grandfathering provision for existing Internet access taxes would in itself be sufficient to subject the bill to the statutory procedural restrictions on unfunded intergovernmental mandates.

CBO estimated that the revenue loss to state and local governments from eliminating existing Internet access taxes alone would exceed the statutory threshold established by the Unfunded Mandates Reform Act of 1995 (UMRA)¹⁴ at some time during the 5-year extension of the moratorium proposed in H.R. 3709. (The threshold for a restricted intergovernmental mandate was a revenue loss of \$55 million per year in 2000 and \$56 million in 2001. The threshold is adjusted annually for inflation.) The rest of the moratorium – on new Internet access taxes and on any multiple and discriminatory taxes on electronic commerce – could add to the cost of the mandate. But, because these prohibited taxes do not yet exist, CBO could not make a meaningful revenue loss estimate for them.¹⁵

In May 2000, the Federation of Tax Administrators estimated a combined revenue loss of \$75 million (from 11 states) for the fiscal year beginning July 1, 2000, if the grandfathering clause were removed.¹⁶ An estimate compiled in March 2001 by Tax Analysts from information provided by revenue officials (from nine states) was that repeal of the grandfather clause would cost state governments approximately

¹³(...continued)

Internet access during the period of the federal moratorium. South Carolina, Department of Revenue, *Internet Access/Electronic Commerce Moratorium*, Administrative Announcement, SC Information Letter #99-9, May 6, 1999. Available online from Tax Analysts [<http://www.taxbase.tax.org>], Document No. Doc 1999-19259, Electronic Citation 1999 STT 109-46.

This does not purport to be a comprehensive listing. Other states may have adopted policies to retract their taxes on Internet access, either temporarily or permanently.

¹⁴UMRA, P.L. 104-4, 2 U.S.C. 1501-1571.

¹⁵U.S. Congressional Budget Office. *H.R. 3709; Internet Nondiscrimination Act of 2000*. Mandates Statement, as ordered reported by the House Committee on the Judiciary on May 4, 2000. 106th Cong., 2nd Sess., Washington, May 8, 2000. Available through the CBO Home Page at [<http://www.cbo.gov>] under Cost Estimates.

¹⁶In addition to the 10 “states with grandfathered taxes” listed in the text, the estimate by the Federation of Tax Administrators (FTA) for May 2000 included Connecticut, whose tax was since repealed. FTA pointed out that Montana was prevented by the moratorium from applying to Internet access charges the state’s retail telecommunications excise tax which is levied on two-way voice, video, and data communications, regardless of the medium. Information obtained from the Federation of Tax Administrators, Washington, DC, May 10, 2000.

\$90 million in revenue loss in the first year alone.¹⁷ Both of these estimates exceed the threshold amount subjecting an unfunded intergovernmental mandate to procedural restrictions (\$56 million in 2001).

None of the proposals to eliminate the grandfathering protection for existing Internet access taxes, or to permanently ban new access taxes, offered federal compensation to state and local governments for the revenue they would lose.¹⁸

The presence of an unfunded intergovernmental mandate in excess of the threshold amount means that a point of order may be raised when a bill is considered on the House or Senate floor.¹⁹ In the case of H.R. 3709, on May 10, 2000, a point of order was raised, but the House voted to consider the measure despite the presence of the unfunded mandate.²⁰

In October 2001, the Congressional Budget Office prepared a cost estimate for H.R. 1552, the Internet Tax Nondiscrimination Act, the bill subsequently enacted as P.L. 107-75. The bill provided for a 2-year extension of the original moratorium, until November 1, 2003. It continued the grandfathering protection for existing taxes on Internet access that was provided under the original moratorium. CBO determined that although the bill would impose an intergovernmental mandate, the revenue losses to state and local governments would not exceed the threshold amount (\$56 million in 2001), because the grandfathering provision was extended.²¹

¹⁷The revenue losses for the first year of a complete ban on Internet access taxes, as estimated by state revenue officials (listed in descending order of revenue loss for individual states), were: Texas \$45 million, Connecticut \$15 million, Ohio \$12 million, Wisconsin \$7.5 million, Tennessee \$4 million, North Dakota \$2.5 million, South Dakota \$1.7 million, and New Mexico \$1 million. The revenue losses from these eight states total \$88.7 million. If Washington's business and occupation tax is included, that is another \$3.9 million, for a total estimated revenue loss of \$92.6 million. These estimates do not include revenues in those states from taxes on Internet access that is bundled together with telephone service. Doug Sheppard, "State Officials: Internet Access Tax Repeal Would Cost \$90 Million," *Tax Notes* (published by Tax Analysts), vol. 90, no. 10, Mar. 5, 2001, 1308-09. The compilation by Tax Analysts did not include Hawaii or New Hampshire.

¹⁸In contrast, several bills introduced in the 107th Congress in the fall of 2001 proposing a state sales tax holiday did provide for the federal government to reimburse the states for lost revenue: H.R. 3172 (Graham), identical bills H.R. 3301(Graham)/S. 1643 (Murray and Snowe), and H.R. 3398 (Israel).

¹⁹For an explanation of congressional procedures required under UMRA, see CRS Report RS20058, *Unfunded Mandates Reform Act Summarized*, by Keith Bea and Richard S. Beth, Washington, February 9, 1999, 4-5.

²⁰For an account of H.R. 3709, see CRS Report RL30412, *Internet Taxation: Bills in the 106th Congress*, by Nonna A. Noto, November 22, 2000, 9-10.

²¹In its cost estimate, CBO determined that, by extending the prohibition on collecting certain types of state and local taxes, H.R. 1552 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). However, because H.R. 1552 would allow states that are currently collecting a sales tax on Internet access to continue doing so, it would not affect state and local revenues currently being collected and, consequently,

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Multiple and Discriminatory Taxes on Electronic Commerce

In addition to the moratorium on new taxes on Internet access, the Internet Tax Freedom Act (ITFA) imposed a moratorium on any “multiple or discriminatory taxes on electronic commerce.” This section of the report provides a definition of the terms electronic commerce, multiple tax, and discriminatory tax. It also explains some of the implications of the definition of discriminatory tax. This includes the reason why a state cannot require an Internet seller to collect use taxes unless the seller has a physical presence (nexus) in the taxing state. It also includes a basis for some companies claiming that they can sell through Internet kiosks (and comparable computer and corporate organizational arrangements) and not be subject to sales and use tax collection requirements.

Electronic Commerce. According to the Internet Tax Freedom Act, “The term ‘electronic commerce’ means any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access.”²²

Multiple Taxes. The ban on multiple taxes prohibits double taxation, or overlapping taxes, by two or more jurisdictions at the same level of government. More precisely, the ban on multiple taxes prohibits more than one state, or more than one local jurisdiction at the same level of government (i.e., more than one county or

²¹(...continued)

the cost of complying with the mandate would not exceed the threshold established in UMRA (\$56 million in 2001).

U.S. Congressional Budget Office, *H.R. 1552: Internet Tax Nondiscrimination Act, as ordered reported by the House Committee on the Judiciary on October 10, 2001*. Cost Estimate, October 12, 2001. Available through the CBO Home Page at <http://www.cbo.gov>. Also included in U.S. Congress, House, *Internet Tax Nondiscrimination Act, Report to Accompany H.R. 1552, Including Cost Estimate of the Congressional Budget Office*, H.Rpt. 107-240, 107th Congress, 1st Session, October 16, 2001, p. 10.

²²The Department of Commerce defines e-commerce sales as “...sales of goods and services where an order is placed by the buyer or price and terms of sale are negotiated over an Internet, extranet, Electronic Data Interchange (EDI) network, electronic mail, or other online system. Payment may or may not be made online.” The emphasis is on the means used to arrange the sales transaction. No reference is made to the means of delivery. E-commerce sales are just one part of electronic commerce as defined in the Internet Tax Freedom Act.

U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau, “Retail E-Commerce Sales in Second Quarter 2001 Were \$7.5 Billion, Up 24.7 Percent from Second Quarter 2000, Census Bureau Reports,” *United States Department of Commerce News*, CB01-141, August 30, 2001, p. 2, footnote 2 to Table 1. E-commerce retail sales data is available on the U.S. Census Bureau’s website at [<http://www.census.gov/mrts/www/mrts.html>].

one city) from imposing a tax on the same transaction – unless a credit is offered for taxes paid to another jurisdiction, to eliminate double taxation.²³

However, the ITFA does permit multiple sales and use taxes that are geographically vertical. The definition of multiple tax makes an exception to permit both a state and one or more of its subdivisions to impose their sales or use tax on the same electronic commerce transaction. For example, the state, county, and city within that county could all levy their sales tax on the same electronic commerce transaction.

Another exception included in the ITFA's definition of multiple tax permits a tax to be levied on persons engaged in electronic commerce (e.g., a personal income tax, corporate income tax, or business activity tax) even if a sales or use tax is levied on the transaction.

To date, multiple taxation has not been cited as an active problem. Multiple taxation could become an issue in a situation where the location of a sale is ambiguous. For example, consider the case of a purchase from a seller in one state, by a person who lives in a second state, over an Internet server in a third state, charged to a credit card account in a fourth state, and delivered as a gift to a person in a fifth state. Multiple taxation could occur if more than one of these states claimed the right to levy a sales or use tax on the sale, without the taxpayer being able to claim a credit for tax paid to another state.

Discriminatory Taxes. The Internet Tax Freedom Act also prohibits “discriminatory taxes on electronic commerce.” The Act defines several types of discriminatory taxes.

A discriminatory tax includes any state or local tax on electronic commerce that is not levied in the same way, at the same rate, or on the same person or entity as on “...transactions involving similar property, goods, services, or information accomplished through other means...” In practice, this means that transactions arranged over the Internet are to be taxed like mail order or telephone sales. Thus, the same nexus standards that apply to sales arranged by mail-order or telephone also apply to Internet transactions.

Under the current judicial interpretation of nexus as applied to mail-order sales, a state cannot require an out-of-state seller to collect a use tax from the customer unless the seller has a physical presence in the taxing state.²⁴ (The use tax is the companion tax to the sales tax, applicable to interstate sales.)²⁵ If the seller does not

²³The tax credit could take the form of a resale exemption certificate.

²⁴For additional discussion, see CRS Report RS20577, *State Sales Taxation of Internet Transactions*, by John R. Luckey, and CRS Report RL30667, *Internet Tax Legislation: Distinguishing Issues*, by Nonna A. Noto, section on “Role of Congress under the Commerce Power,” 3-4.

²⁵Every state with a sales tax has a corresponding use tax, typically defined as a tax upon the storage, use, or consumption of tangible personal property in the state.

collect the use tax on an interstate sale, it is the buyer's obligation to pay the tax to his home state. But voluntary use-tax compliance by non-business customers is low.²⁶

The definition of discriminatory tax also includes a tax that would classify Internet access service providers or online service providers for purposes of taxing them at a higher tax rate than generally applies to similar information services delivered through other means.

The second part of the ITFA's definition of discriminatory tax addresses nexus issues. It lists conditions under which the use of a computer server, an Internet access service, or online services, by a remote seller, does not establish nexus. Circumstances that do not establish nexus include the sole ability to access a site on a remote seller's out-of-state computer server; the display of a remote seller's information or content on the out-of-state computer server of a provider of Internet access service or online services; and the processing of orders through the out-of-state computer server of a provider of Internet access service or online services. (In these examples, "out-of-state" refers to a state other than the state wishing to tax the sales transaction.)

Internet Kiosks. Some businesses have taken advantage of these nexus limits in the ITFA's definition of discriminatory tax to establish what are referred to as "Internet kiosks." The businesses claim that orders placed through these computer kiosks are not subject to sales tax collection requirements. Briefly, a company already operating a bricks-and-mortar retail business sets up a separate business or corporate entity, sometimes referred to as a dot-com subsidiary. The subsidiary is designed to receive sales orders over the Internet and ship the product to the customer, often across state lines. The subsidiary's computer terminals are placed in the parent company's bricks-and-mortar stores, in what is called an Internet kiosk. Because of the abovementioned language in the ITFA, some sellers claim that a tax on an order placed through an Internet kiosk in one state to a seller located in, and shipping from, another state is considered a discriminatory tax, prohibited by the moratorium.

Critics of the current definition of discriminatory tax disagree with the claim that a dot-com subsidiary does not have nexus (currently defined as physical presence) in the state where the kiosk is located. The criticism of nexus-free status becomes even stronger in cases where customers are permitted to return to the bricks-and-mortar store products they ordered over the Internet and received by mail or other delivery service. State and local governments and Main Street retailers are concerned that if Congress does not signal its support for taxing Internet commerce like "bricks and mortar" commerce, many types of businesses will aggressively pursue Internet technology and business structures specifically designed to avoid state and local tax liability.

²⁶For further discussion, see the introduction to the section below on "Collecting Sales and Use Taxes on Interstate Sales."

Related Issues

Collecting Sales and Use Taxes on Interstate Sales

Under current law, sellers with nexus (defined as physical presence) in a state are already required to collect state tax on their sales arranged over the Internet, or by other means, to customers in that state. In-state sellers are required to collect sales taxes. Out-of-state sellers with physical presence in the state (such as a warehouse or retail store) are required to collect use taxes.²⁷

If the out-of-state seller does not collect the use tax, it is the buyer's obligation to pay the use tax to the buyer's home state. In practice, however, voluntary compliance by non-business purchasers is low. Consequently, states have long wanted to be able to require out-of-state sellers without physical presence in the state (referred to as remote sellers) to collect the use tax from the customer and remit it to the customer's home state. This would apply to all interstate sales, whether arranged over the Internet, or by telephone, mail order, in person, or other means. With or without the Internet tax moratorium, separate congressional action would be needed in order for states to obtain the authority to require out-of-state sellers without nexus in the state to collect use taxes from customers at the time of the sale.

A major controversy surrounding the bills to extend the Internet tax moratorium was whether Congress was willing to include any language that signaled its support for the states' effort to have remote sellers collect use taxes on interstate sales. Some of the bills introduced in the 107th Congress to extend the Internet tax moratorium did include language addressing the use tax collection issue. The moratorium extension bill that was enacted, H.R. 1552 (P.L. 107-75), did not. However, before voting to approve H.R. 1552 as received from the House, the Senate debated the Enzi-Dorgan amendment (S.Amdt. 2155 to H.R. 1552), which addressed the sales and use tax collection issue in considerable detail. The amendment was tabled by a vote of 57 to 43. Still, both during the debate and after the votes in the Senate, several Senators expressed their intention to pursue an agreement on the sales tax simplification and collection issues raised in the Enzi-Dorgan amendment during the added 2 years of the moratorium.²⁸

Underlying Debate over the Taxation of Internet Sales. Briefly, the conflict underlying the debate over whether Congress should support state and local taxation of interstate sales conducted over the Internet, or by other means, is as follows. Many state and local governments are concerned about substantial further erosion of their sales tax base if a growing fraction of the economy can operate tax-free over the Internet.^{29, 30} These can be thought of as the "consumer states." Sales

²⁷Similar nexus rules (physical presence in the local jurisdiction) apply to requiring sellers to collect local sales and use taxes.

²⁸*Congressional Record*, Daily Edition, vol. 147, Nov. 15, 2001; floor debate, S11902-15; text of S.Amdt. 2155, S11963-64.

²⁹The sales tax base has already been eroded by not taxing most services, by exempting some
(continued...)

taxes on purchases made by their residents are a major source of revenue supporting state and local government services. This is more so for states with a sales tax but no income tax.³¹ There is also a “digital divide” concern that the sales tax will become even more regressive if higher income people have access to tax-free Internet shopping, while lower income people do not. Joining in support of taxation are “bricks-and-mortar” retailers who are required to collect sales tax from customers and feel it is unfair for them to face competition from Internet merchants who are not required to collect the parallel use tax. These “Main Street” retailers seek a level playing field with respect to sales and use taxes.³²

On the opposite side of the issue, businesses engaged in interstate commerce point out the administrative compliance burden they could face if they were subject to the disparate sales and use tax laws, filing requirements, and tax rates of 7,500 (now and potentially 30,000 authorized) state and local taxing jurisdictions. Joining them in opposition to taxation are those states and localities that expect to benefit more from the growth of Internet businesses than they would from being able to collect use taxes on interstate Internet sales. These can be thought of as the “technology producer states.” In addition, states with no sales tax have little reason to pursue taxation of Internet sales.³³

(The reference section at the end of this report lists the names and World Wide Web sites of organizations that provide arguments against, followed by organizations that provide arguments for, requiring remote sellers to collect sales and use taxes on interstate sales.)

Role of Congress. In its 1967 *National Bellas Hess*³⁴ decision, and again in its 1992 *Quill* decision,³⁵ the U.S. Supreme Court denied states the ability to require a seller to collect use taxes on interstate mail-order sales unless the seller had a physical presence in the taxing state. The Court concluded that the complexity of state and local sales tax systems imposed an undue burden on interstate commerce. However, in its 1992 *Quill* decision, the Court indicated that Congress has the power, under the Commerce Clause of the U.S. Constitution, to address the issue of granting

²⁹(...continued)

major categories of tangible goods (such as some food, medicine, and clothing), and by the operation of tax-free interstate mail order and telephone sales.

³⁰This viewpoint is represented by the National Governors’ Association (NGA) [<http://www.nga.org>].

³¹Seven states have no income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Two states have limited income taxes, on interest and dividend income: New Hampshire and Tennessee. Of these states, Alaska has no state sales tax but permits local sales taxes. New Hampshire has no state or local sales taxes.

³²This viewpoint is represented by the e-Fairness Coalition [<http://www.e-fairness.org>].

³³Delaware, Montana, New Hampshire, and Oregon do not levy state or local sales taxes. The state of Alaska does not levy a sales tax, but its local jurisdictions are permitted to do so.

³⁴*National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967).

³⁵*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

states the authority to require out-of-state sellers to collect use taxes on interstate purchases by their residents. The Court invited the Congress to act. To date, Congress has not addressed this issue.³⁶

Connection to Extending the Moratorium. The bills to extend the Internet tax moratorium took one of three basic approaches to the sales and use tax collection issue.

- Most extension bills did not address the tax collection issue at all.
- Some bills laid out conditions under which Congress would, or might, grant the states authority to require collection.
- Offering a middle ground, some bills included a sense of Congress provision encouraging continued state-business efforts at sales tax simplification.

Simplifying the administration of state and local sales and use taxes is considered a prerequisite to asking Congress to grant states the authority to require out-of-state sellers to collect use taxes from customers on interstate sales. This applies whether the sales are arranged in person, over the Internet, by mail order, telephone, or other means. The practical question linked to extending the moratorium is: can the states develop and implement a sales and use tax system that would not be an undue burden on interstate commerce; and, if so, how long would that take to accomplish?

Often, the position taken on granting the states use-tax collection authority affected the position taken on how long to extend the Internet tax moratorium. This link could be present even if the moratorium extension bill did not make explicit reference to the sales and use tax issue.

Some supporters of tax collection on remote sales wanted the extension of the moratorium to be long enough for the states to accomplish meaningful sales tax simplification, but not so long that the perception of the Internet as a tax-free shopping zone became taken for granted, or that many sellers would develop dot-com subsidiaries to avoid collecting the sales tax. They wanted to keep time pressure on the states to accomplish simplification and on Congress to consider the collection issue. They generally preferred a shorter extension of the moratorium. If the bill made no mention of the tax collection issue, that generally meant supporting an extension of 2 years (as in the bill enacted, H.R. 1552/ P.L. 107-75) or less. Those skeptical of the ability of state and local governments to quickly agree upon and implement meaningful sales tax simplification were willing to support a longer extension, of 4 or 5 years, if language addressing tax collection was included in the bill.

Opponents of taxing remote commerce favored a longer (4- or 5-year), if not permanent, extension of the moratorium, with no mention of the sales tax simplification and collection issue. This group included opponents of granting states

³⁶For additional discussion, see CRS Report RS20577, *State Sales Taxation of Internet Transactions*, by John R. Luckey, and CRS Report RL30667, *Internet Tax Legislation: Distinguishing Issues*, by Nonna A. Noto, section on “Role of Congress under the Commerce Power.”

interstate sales and use tax collection authority. It also included those seeking protection from state business activity tax (BAT) liability for businesses operating in multiple states unless they had “substantial physical presence” in a state; this is known as the BAT nexus issue.

Streamlined Sales Tax Project (SSTP) and SSTIS. The detailed work on simplifying the administration of state and local sales and use taxes is being conducted by the Streamlined Sales Tax Project (SSTP). The SSTP is expected to serve as a technical advisory group to the Streamlined Sales Tax Implementing States (SSTIS), which began to meet at the end of November 2001.

The SSTP is a voluntary, cooperative effort among state governments, with input from local governments and the private sector. As of December 2001, 33 states were formal voting participants in the SSTP, with six other states participating as observers.³⁷

The SSTP formally began its work in March 2000. The project has two main components. One is to simplify and modernize the administration of state and local sales and use taxes. The other is to identify the computer software and a financial transmission system that could be used to collect use taxes on out-of-state sales at a reasonable cost.³⁸

The initial purpose of the Streamlined Sales Tax Project was to get the states to simplify their sales tax systems enough that remote (out-of-state) sellers would be willing to collect use taxes on a voluntary basis. Simplification of sales tax administration would benefit in-state retailers as well. The longer-run hope was that once compliance costs for sellers had been reduced to a reasonable level (imposing no undue burden on interstate commerce), Congress might be willing to authorize states to require use tax collection by remote sellers without nexus, or the Supreme Court might revise the *Quill* decision’s requirement of physical presence for nexus in a future tax-collection case.

The SSTP approved its version of a model act and agreement on January 24, 2001, for consideration by the states during their 2001 legislative sessions.³⁹ The

³⁷The 33 states that were formal voting participants in the Streamlined Sales Tax Project, under a statute or executive order, were: Alabama, Arkansas, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. The six observer states were: California, Colorado, Connecticut, Georgia, Idaho, and Pennsylvania. Altogether, 45 states and the District of Columbia levy sales and use taxes.

³⁸More information about the Streamlined Sales Tax Project is available on their Web site [<http://www.streamlinedsalestax.org>] or [<http://www.geocities.com/streamlined2000/>].

³⁹The SSTP’s model legislation is formally known as the Uniform Sales and Use Tax Administration Act. The Act provides the authority for a state to enter into agreement with other states to implement the new system and lists the general requirements for what the

(continued...)

National Conference of State Legislatures (NCSL) approved its own version of the act and agreement on January 27, 2001, dropping some of the SSTP criteria for simplification.⁴⁰

During 2001, 20 states enacted legislation authorizing participation with other states in developing a multi-state sales tax agreement.⁴¹ Some states approved the version of the model act drafted by the SSTP; other states approved the version drafted by the NCSL. Some states made their own modifications to one of these model laws. The states that enacted legislation authorizing participation became the members of the Streamlined Sales Tax Implementing States (SSTIS).

The purpose of the SSTIS is to finalize an interstate agreement to simplify and modernize sales and use tax administration and then to recommend the agreement to the states for implementation. Any state that enacts legislation to authorize participation in an interstate agreement (either the SSTP or the NCSL version) may still become a voting member of the SSTIS.⁴²

Delegates from the SSTIS met for the first time on November 28 and 29, 2001, in Salt Lake City to elect officials and adopt operating rules. The SSTIS is trying to complete a uniform interstate sales tax agreement by the summer of 2002. This would leave time for the SSTIS to transmit the model agreement to state legislatures for their consideration during the 2003 legislative session, before the moratorium extension ends on November 1, 2003.

During 2000 and 2001, the SSTP made progress in reaching agreement on many detailed components involved in designing a simplified sales and use tax system. Nevertheless, considerable work still remains to be done by the SSTP in specifying details of the multistate simplified sales tax agreement. Once an agreement is drawn up by the SSTIS, individual states then need to adapt their tax laws to the agreement.

³⁹(...continued)

Agreement must contain. The SSTP's compact is known as the Streamlined Sales and Use Tax Agreement. The Agreement sets forth the specific elements of the new sales and use tax system. A state must enact the simplifications and other aspects of the Agreement to be in compliance and become a participant in the new system. A draft of the Act was initially approved by the SSTP's voting states on December 22, 2000.

⁴⁰The NCSL's model act is known as the Simplified Sales and Use Tax Administration Act. The NCSL's compact, containing its simplification provisions, is known as the Streamlined Sales and Use Tax Agreement, the same name as the SSTP's agreement.

⁴¹As of December 2001, the 20 states that belonged to the Streamlined Sales Tax Implementing States (SSTIS) were Arkansas, Florida, Illinois, Indiana, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Nebraska, Nevada, North Carolina, North Dakota, Oklahoma, Rhode Island, Tennessee, Texas, Utah, Wisconsin, and Wyoming. The District of Columbia also approved authorizing legislation and had a delegate to the SSTIS. Ten other states had pending legislation to authorize participation in developing a multistate agreement: Alabama, Iowa, Kansas, Massachusetts, Missouri, New Jersey, Ohio, Pennsylvania, South Dakota, and Vermont.

⁴²Streamlined Sales Tax Implementing States, Rules of Procedure, released November 28, 2001 in Salt Lake City, Utah.

Finally, the simplified system needs to be put into practice by tax administrators and vendors in participating states.

The states currently have no indication whether, after all of their efforts to simplify their sales and use tax systems, Congress will grant them authority to require remote sellers to collect use taxes. Some would like Congress to specify in law the criteria that the states need to meet in order for Congress to grant them collection authority.

On the other side, Congress currently has no assurance about the final outcome of the states' sales tax simplification effort. Consequently, even those sympathetic to the states' request for collection authority may be reluctant to grant that authority in advance of seeing the actual streamlined sales tax system that emerges from the SSTP and SSTIS efforts by the states.

Bill Provisions on Granting States Tax Collection Authority. Most of the bills to extend the Internet tax moratorium did not address the sales and use tax collection issue at all. No provisions addressing sales tax collection issues were included in H.R. 1552, the bill passed by both the House and Senate and enacted as P.L. 107-75. The new law simply extended the prior moratorium by 2 years, until November 1, 2003.

The full House did not address the sales tax collection issue.⁴³ The issue received more attention on the Senate side. In February and March of 2001, Senator Wyden and Senator Dorgan, respectively, each introduced moratorium extension bills that also addressed the issue of granting a state the authority to require out-of-state sellers to collect and remit use taxes to the buyer's home state, if that state met certain criteria for simplifying its sales and use tax. S. 288 (Wyden) would have permanently extended the moratorium on Internet access taxes, removed the grandfathering protection for existing access taxes, and extended the moratorium on multiple and discriminatory taxes by 5 years. S. 512 (Dorgan) would have extended both parts of the moratorium, and the grandfathering protection, for 4 years. S. 288 and S. 512 set somewhat different simplification criteria and substantially different procedures for Congress to grant states sales tax collection authority.

In early October 2001, Senators Wyden and Dorgan each introduced a bill for a shorter time extension that included only a "sense of Congress" provision encouraging state governments and interested business organizations to expedite efforts pursuing a simplified tax system that would not impose an undue burden on interstate commerce. S. 1481 (Wyden) referred to developing "...a streamlined simplified plan for protecting State revenues affected by Internet use...." It would

⁴³H.R. 1410 (Istook), a bill identical to S. 512 (Dorgan), was introduced in the House. A hearing on H.R. 1410 was held by the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary, but the subcommittee did not report the bill. U.S. Congress. House. Committee on the Judiciary. Subcommittee on Commercial and Administrative Law. *Internet Tax Moratorium and Equity Act; Hearing on H.R. 1410*. Serial No. 31, 107th Cong., 1st Sess., July 18, 2001 (Washington: U.S. Govt. Print. Off., 2001).

have extended the moratorium by 2 years, until October 21, 2003. S. 1504 (Dorgan) referred more specifically to developing “...a streamlined sales and use tax system that, once approved by Congress, would allow sellers to collect and remit sales and use taxes....” It would have extended the moratorium by eight months, until June 30, 2002.

Substantial efforts were made, first in the Senate Commerce Committee and later by Senator Mike Enzi, to reach a compromise between S. 288 and S. 512, the first bills introduced by Senators Wyden and Dorgan. In mid-October 2001, Senator Enzi introduced S. 1542 and then S. 1567. He finally introduced S.Amdt. 2155, known as the Enzi-Dorgan amendment, on the Senate floor on November 15, 2001, as an amendment in the nature of a substitute to H.R. 1552. The amendment was tabled by a vote of 57 to 43 before the Senate passed H.R. 1552 as received from the House.

The Enzi-Dorgan amendment drew upon elements from both S. 288 (Wyden) and S. 512 (Dorgan). Like S. 288, S.Amdt. 2155 would have made the ban on Internet access taxes permanent. But, like S. 512, it would have extended the grandfathering protection for existing Internet access taxes and extended the ban on multiple and discriminatory taxes by 4 years and some months, until December 31, 2005 (not 5 years, as under S. 288). S.Amdt. 2155 included a procedure for congressional approval based on S. 288, but tax simplification criteria from S. 512.

S. 512 (Dorgan) proposed a mechanism in the form of a multi-state compact through which Congress would grant a participating state the authority to require collection if the state conformed with certain simplification requirements. This opportunity for congressional authorization and consent would expire if the compact was not formed before the end of the extended moratorium. The compact would take effect automatically once signed by 20 states and sent to Congress, if Congress did not take action to disapprove the compact within 120 days (known as a “negative trigger”).

In contrast, S. 288 (Wyden) proposed an expedited (“fast-track”) procedure for congressional consideration of a joint resolution to give states the authority to require collection of use taxes once states had simplified their tax system. This approach reflects the view that Congress must retain the authority to review and actively approve any simplification compact before authorizing the states to require remote sellers to collect taxes (a “positive trigger”).

The compromise amendment, S.Amdt. 2155 (Enzi-Dorgan), included more detailed provisions than S. 288 (Wyden) providing expedited procedure for Congress to consider a joint resolution to give states the authority to require collection of use taxes if the states adequately simplified their sales and use tax systems and adopted an interstate compact (again, a “positive trigger”). Like S. 512, S.Amdt. 2155 gave the states until the end of the extended moratorium to form the compact and required that 20 states sign the compact before it was transmitted to Congress for approval.

S.Amdt. 2155 built upon the criteria for a streamlined sales and use tax system enumerated in S. 512 (Dorgan).⁴⁴ Notably, while the criteria call for uniform definitions for goods or services, they do not call for a uniform tax base across the states. Individual states could still choose which particular goods and services would be included in, or exempt from, their sales and use tax base.⁴⁵

S.Amdt. 2155 also included S. 512's sense of Congress provision that state and local governments and business should jointly commission a study of the cost to all sellers (presumably, both local and remote) of collecting and remitting state and local sales and use taxes, under current tax law and under the streamlined system outlined in the bill. The purpose of the study is to help determine reasonable government compensation to sellers for collecting taxes.

A difference between S. 288 and S. 512 that is of particular importance to local governments regards the local-option sales tax rate. S. 288 would have required one

⁴⁴S.Amdt. 2155 (Enzi-Dorgan) added criteria (13) and (14) to the 12 sales and use tax simplification criteria listed in S. 512 (Dorgan), S. 1542 (Enzi), and S. 1567 (Enzi), in a sense of Congress provision:

- (1) a centralized, one-stop, multi-state reporting, submission, and payment system for sellers;
- (2) uniform definitions for goods or services, the sale of which may, by state action, be included in the tax base;
- (3) uniform rules for attributing transactions to particular taxing jurisdictions;
- (4) uniform procedures for the treatment of purchasers exempt from sales and use taxes system, and relief from liability for sellers that rely on such state procedures;
- (5) uniform procedures for the certification of software that sellers rely on to determine sales and use tax rates and taxability;
- (6) uniform format for tax returns and remittance forms;
- (7) consistent electronic filing and remittance methods;
- (8) state administration of all state and local sales and use taxes;
- (9) uniform audit procedures, including a provision giving a seller the option to be subject to no more than a single audit per year using those procedures; except that if the seller does not comply with the procedures to elect a single audit, any state can conduct an audit using those procedures;
- (10) reasonable compensation for tax collection by sellers;
- (11) exemption from use tax collection requirements for remote sellers falling below a de minimis threshold of \$5,000,000 in gross annual sales;
- (12) appropriate protections for consumer privacy;
- (13) uniform enforcement criteria and a process for ensuring compliance by those states that adopt the streamlined sales and use tax system;
- (14) a process for resolving conflicts of law among states in the interpretation or application of statutory or regulatory provisions implementing the system; and
- (15) such other features that the states deem warranted to promote simplicity, uniformity, neutrality, efficiency, and fairness.

With a few exceptions, the first 12 are similar to the criteria included in H.R. 3709, passed by the House on May 10, 2000, in the 106th Congress. This list does not include uniform bad debt rules. It elaborates on the simpler “uniform audit procedures.” It specifies a dollar value of \$5 million for the de minimis threshold.

⁴⁵See criterion (2) in the previous footnote.

sales and use tax rate per state, applied to in-state as well as interstate sales. (An average local sales tax rate could be added to the state rate, but there could be no variation in the rate charged across local jurisdictions within a state.)

In contrast to S. 288, S.Amdt. 2155, like S. 512, provided that a remote seller could have the annual option of collecting the actual applicable state and local use tax rate (as a local seller would), as an alternative to collecting a single, uniform, statewide use tax rate. Furthermore, a state that adopted the dramatically simplified tax system described in the interstate compact could require the remote seller to collect the actual state and local tax due if the state provided the seller relief from liability for relying on (tax rate) information provided by the state. (Supporters argue that computer software is, or will soon be, available to make that feasible at a reasonable administrative cost.)

Both S.Amdt. 2155 and S. 512 provided that the uniform tax rate on remote sales in a calendar year could be no greater than the weighted average of the sales tax rates actually imposed by the state and its local jurisdictions during the prior fiscal year (specifically, during the 12-month period ending on June 30 prior to the calendar year). The test criterion was that the uniform average rate would not have yielded a greater total assessment of taxes than the total taxes actually assessed during the base period, if the uniform rate had actually been applied during the prior fiscal year on all sales subject to state and local sales and use taxes by that state and its local jurisdictions.

S.Amdt. 2155 added some new provisions of its own. To address the concern about the bundling of taxable services with tax-protected Internet access, it defined Internet access services to exclude the receipt of content or services (other than Internet access services). To address the concerns about business activity tax nexus, it contained a sense of Congress provision that legislation be enacted by the end of the 107th Congress to determine the factors establishing business activity nexus.

The Senate debated S.Amdt. 2155, the Enzi-Dorgan amendment to H.R. 1552, for over one hour, before voting, 57 to 43, to table the amendment. The Senate then passed H.R. 1552 as approved by the House. Both during the debate and after the votes in the Senate on November 15, 2001, several Senators expressed their intention to pursue an agreement on the sales tax simplification and collection issues during the added 2 years of the moratorium.⁴⁶

⁴⁶For a recounting of developments during 2001, see Doug Sheppard, "No Kinder, Gentler Internet Tax Battle in 2001," *State Tax Notes*, Dec. 28, 2001, p. 1068-75. Available online from Tax Analysts [<http://www.taxbase.tax.org>]. Document No. Doc 2002-90, Electronic Citation 2001 STT 251-19.

For Additional Information

CRS Reports

CRS Report RL31158. *Internet Tax Bills in the 107th Congress: A Brief Comparison*, by Nonna A. Noto.

CRS Report 98-509. *Internet Tax Bills in the 105th Congress*, by Nonna A. Noto.

CRS Report RL30667. *Internet Tax Legislation: Distinguishing Issues*, by Nonna A. Noto. (Analyzes the bills in the 106th Congress.)

CRS Report RL30412. *Internet Taxation: Bills in the 106th Congress*, by Nonna A. Noto.

CRS Report RL30431. *Internet Transactions and the Sales Tax*, by Steve Maguire.

CRS Report RS20577. *State Sales Taxation of Internet Transactions*, by John R. Luckey.

Other Congressional Reports

U.S. Congress. House. *Internet Tax Nondiscrimination Act*. Report to Accompany H.R. 1552, Including Cost Estimate of the Congressional Budget Office. H.Rpt. 107-240, 107th Congress, 1st Session, October 16, 2001.

U.S. Congress. Joint Committee on Taxation. *Overview of Issues Related to the Internet Tax Freedom Act and of Proposals to Extend or Modify the Act*. Scheduled for a Hearing Before the Senate Committee on Finance on August 1, 2001. JCX-64-01, 107th Congress, 1st Session, July 30, 2001.

U.S. Congressional Budget Office. *Economic Analysis of Taxing Internet and Other Remote Sales*. Statement of G. Thomas Woodward, Assistant Director for Tax Analysis. CBO Testimony before the U.S. Senate, Committee on Finance. August 1, 2001.

U.S. General Accounting Office. *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*. GAO report GGD/OCE-00-165. Washington, June 30, 2000.

Hearings in the 107th Congress

U.S. Congress. House. Committee on the Judiciary. Subcommittee on Commercial and Administrative Law. *Internet Tax Nondiscrimination Act*. Hearing on H.R. 1552 and H.R. 1675. Serial No. 26, 107th Cong., 1st Sess., June 26, 2001. Washington: U.S. Govt. Print. Off., 2001.

— *Internet Tax Moratorium and Equity Act*. Hearing on H.R. 1410. Serial No. 31, 107th Cong., 1st Sess., July 18, 2001. Washington: U.S. Govt. Print. Off., 2001.

— *Internet Tax Fairness Act of 2001*. Hearing on H.R. 2526. Serial No. 41, 107th Cong., 1st Sess., September 11, 2001. Washington: U.S. Govt. Print. Off., 2001.

U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Hearing on Extension of the Internet Tax Moratorium. 107th Cong., 1st Sess., March 14, 2001.

— Committee on Finance. Cybershopping and Sales Tax: Finding the Right Mix. Hearing. 107th Cong., 1st Sess., August 1, 2001.

Resources Available on the World Wide Web

Advisory Commission on Electronic Commerce. Internet Home Page.
[<http://www.ecommercecommission.org>]

For coverage of arguments against requiring remote sellers to collect sales and use tax on interstate sales, see:

Direct Marketing Association.

DMA Web site for the Internet use tax issue. [<http://www.simplifytax.org>]

DMA Web site. [<http://www.the-dma.org>]

e-Freedom Coalition. Internet Home Page.

[<http://www.e-freedom.org>]

Information Technology Association of America (ITAA). Internet Home Page.

[<http://www.itaa.org>]

Internet Tax Fairness Coalition. Internet Home Page.

[<http://www.salestaxsimplification.org>]

Representative Christopher Cox's Office. Internet Tax Freedom Act Home Page.

[<http://www.house.gov/cox/nettax>]

For coverage of arguments in support of requiring remote sellers to collect sales and use tax on interstate sales, see:

e-Fairness Coalition. (Represents over 1.5 million retailers, retail and real estate associations, shopping centers, and the Newspaper Association of America.) Internet Home Page. [<http://www.e-fairness.org>].

National Conference of State Legislatures (NCSL). Internet Home Page.

[<http://www.ncsl.org>].

National Governors' Association (NGA). Internet Home Page.

[<http://www.nga.org>].

National Retail Federation. Sales tax fairness Web site.
[<http://www.salestaxfairness.com>]

Streamlined Sales Tax Project (SSTP). Internet Home Page.
[<http://www.streamlinedsalestax.org>] or
[<http://www.geocities.com/streamlined2000/>]