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Internet Tax Bills in the 108th Congress

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Summary

The Internet Tax Freedom Act, enacted in October 1998 and extended for two years in November 2001, is scheduled to expire on November 1, 2003. The federal moratorium prohibits state and local governments from levying new taxes on Internet access and any multiple or discriminatory taxes on electronic commerce. Taxes on Internet access that were in place prior to October 1, 1998, are protected by a grandfather clause.

The House approved H.R. 49 by voice vote under a suspension of the rules on September 17, 2003. H.R. 49 as passed would permanently extend the moratorium, eliminate the grandfathering protection, and exempt from state and local taxes any form of telecommunications used to provide Internet access. The bill introduced by Representative Cox was replaced by a technical amendment in the Subcommittee on Commercial and Administrative Law and further amended by the Judiciary Committee to provide for neutrality in the tax ban across all modes of Internet access.

S. 150 (Allen) was amended and ordered reported by the Senate Commerce Committee on July 31. S. 150 as amended would permanently extend the moratorium, continue the grandfathering protection for three more years, alter the definition of Internet access like H.R. 49 to provide for technological neutrality involving the moratorium, and clarify that the ITFA does not prevent the federal government or the states from imposing or collecting fees or charges on telecommunications used to finance the universal service program. Senators Allen and Wyden agreed to further refine the definition of Internet access before the bill reaches the Senate floor. On September 29, S. 150 was reported by Commerce and sequentially referred to the Finance Committee for a period of up to 30 days.

CBO found that eliminating the grandfathering protection under either H.R. 49 or S. 150 would impose an intergovernmental mandate. The Bush Administration supports extending the moratorium.

Two other bills to extend the moratorium have been introduced in the 108th Congress. S. 52 (Wyden) was the companion to H.R. 49 (Cox) as introduced. It would make the moratorium permanent and remove the grandfathering protection. H.R. 1481 (Lofgren), would extend the current moratorium for five years.

An issue previously raised in connection with the Internet tax moratorium is being addressed separately in this Congress: streamlined sales taxes and remote tax collection authority. H.R. 3184 (Istook) would grant states that comply with the Streamlined Sales and Use Tax Agreement (a multistate compact) the authority to require remote sellers to collect state and local taxes on interstate sales. A related issue is whether and how to have Congress set the nexus standards under which a state is entitled to impose its business activity tax (BAT, e.g., corporate income tax) on a company located outside the state but with activities in the state. H.R. 3220 (Goodlatte and Boucher) would establish a physical presence standard for business activity taxes. This report will be updated as legislative events warrant.

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Background

The Internet Tax Freedom Act (ITFA) was enacted on October 21, 1998, as Title XI of Division C of P.L. 105-277, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999.[1] The ITFA placed a three-year moratorium on the ability of state and local governments to (1) impose new taxes on Internet access or (2) impose any multiple or discriminatory taxes on electronic commerce. The Act grandfathered the state and local access taxes that were "...generally imposed and actually enforced prior to October 1, 1998 ...."

The original Internet tax moratorium expired on October 21, 2001. The Internet Tax Nondiscrimination Act, P.L. 107-75, was enacted on November 28, 2001. It provided for a two-year extension of the prior moratorium, through November 1, 2003. It also continued the grandfathering protection for pre-existing Internet access taxes. Thus, absent congressional action, the moratorium will expire in 2003, during the first session of the 108th Congress.

The House passed H.R. 49 on September 17, 2003. The Senate Commerce Committee ordered S. 150 reported on July 31, 2003. Each bill would extend the moratorium permanently and make other changes to the ITFA.

Issues

The five main issues surrounding legislation to extend the Internet tax moratorium are

- Should the moratorium be extended temporarily, permanently, or allowed to sunset?
- Should the grandfathering from the moratorium of existing taxes on Internet access be continued or eliminated?
- Should the definitions of Internet access and discriminatory taxes be amended?

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[1] Title XII was also part of S. 442, 105th Congress, the underlying ITFA.legislation. Titles XI and XII, 112 Stat. 2681-719 through 728 (1998). Title XI is codified as the ITFA in 47 U.S.C. 151 note. Title XII is codified as 19 U.S.C. 2241 note.

- Will Congress consider granting states the authority to require remote sellers to collect use taxes if the states adopt a streamlined sales tax system?

- Will Congress codify guidelines for establishing whether or not a business engaged in interstate commerce has nexus in a jurisdiction for purposes of business activity tax (BAT, e.g. corporate income tax) liability?[2]

Extension of the Moratorium: Permanent, Temporary, or Sunset?

The intent of the Internet Tax Freedom Act enacted in 1998 was to halt the proliferation of taxes on Internet access, to guarantee that more than one jurisdiction could not tax the same electronic commerce transaction, and to guarantee that commerce over the Internet would not be singled out for discriminatory tax treatment, that is, taxation not applied to commerce in similar products that is conducted by other means. Supporters of the moratorium felt that the Internet should be protected from the administrative and financial burdens of taxation in order to encourage the advance and dissemination of Internet technology and the economic activity developing around it. Opponents objected that a federal moratorium was an infringement on the states' independent authority to levy taxes and argued that taxes specifically on the Internet were not proliferating.

Strong supporters of the original moratorium would generally like to see the moratorium extended beyond 2003, preferably permanently. Those who acquiesced to a temporary moratorium as a pause to evaluate the effects of the Internet and the condition of state and local sales taxes might agree to another temporary moratorium, accompanied by an agenda to be accomplished during the extension. Those who feel that the states can be trusted to treat the Internet in a fair manner believe that the federal moratorium could be allowed to sunset.

A permanent extension of the moratorium would eliminate the need for Congress to revisit the issues surrounding Internet taxation when a temporary moratorium expired. Permanent extension presumably would also provide both the producers and consumers of Internet services greater certainty about the absence of future state and local taxation of the Internet.

In contrast, a temporary extension of the moratorium would set a future time for Congress to review the conditions of the moratorium. The reassessment could be made in the context of developments in computer technology and business organization, as well as state and local government revenues. A temporary extension

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[2] The issues remain similar to those considered in 2001 when the Internet tax moratorium was temporarily extended for two years. For a longer discussion of the extension of the moratorium, grandfathering of existing access taxes, and collecting sales and use taxes on interstate sales — in relation to bills introduced in the first session of the 107th Congress — see CRS Report RL31177, *Extending the Internet Tax Moratorium and Related Issues*, by Nonna A. Noto.

would also provide an interval for the states to further simplify their sales and use taxes. States could then hope that, the next time an extension of the moratorium was considered, Congress might consider granting states the authority to require remote (out-of-state) sellers to collect use taxes from customers at the time of the sale. (See the discussion below on *Streamlined Sales Taxes and Remote Collection Authority*.)

Allowing the moratorium to sunset would permit the states to tax Internet access. In practice, however, the trend has been for states to repeal their Internet access taxes. With or without the moratorium, Congress would need to act before states could gain the authority to require out-of-state sellers without physical presence in the state to collect use taxes from consumers.

The Bush Administration supports extending the Internet tax moratorium before the current moratorium ends on November 1, 2003.[3] Both H.R. 49, as passed by the House, and S. 150, as reported by the Senate Commerce Committee, would permanently extend the moratorium.

Grandfathering of Existing Access Taxes: Continue or Not?

The Internet Tax Freedom Act grandfathered from the moratorium taxes on Internet access that were "... generally imposed and actually enforced prior to October 1, 1998...." When ITFA legislation was being considered in the spring of 1998, 10 states and the District of Columbia were applying their sales and use tax to Internet access.[4] Subsequently, Connecticut, Iowa, and the District of Columbia eliminated their tax on Internet access, and South Carolina has not enforced the collection of its tax during the federal moratorium. This left seven states imposing a sales and use tax on Internet access as of April 2003: New Mexico, North Dakota, Ohio (on businesses only, not consumers), South Dakota, Tennessee, Texas (on monthly charges over $25), and Wisconsin.[5] In addition, Hawaii levies its general excise tax, New Hampshire its communications services tax (imposed on all two-way communications equipment), and Washington state its business and occupation tax (a gross receipts tax levied on business) on Internet access.

The grandfathering protection was continued when the ITFA moratorium was extended for two years in 2001. The issue now is whether the grandfathering will be continued if the moratorium is extended beyond 2003, either temporarily or permanently.

In the 107th Congress, bills to temporarily extend the moratorium typically extended the grandfathering protection. In contrast, bills to permanently extend the moratorium were divided between those retaining the grandfathering and those

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[3] Letter from Treasury Secretary John W. Snow and Commerce Secretary Donald L. Evans to House Judiciary Committee Chairman F. James Sensenbrenner, Washington, May 14, 2003.

[4] National Conference of State Legislatures, "Which States Tax Internet Access?" March 25, 1998, available online at [http://www.ncsl.org/programs/fiscal/intertax.htm].

[5] Vertex, Inc., *Tax Cybrary*, available online at [http://www.vertexinc.com].

eliminating it. In the 108th Congress, H.R. 49, as passed by the House, would eliminate the grandfathering protection. S. 150, as reported by the Senate Commerce Committee, would extend the grandfathering protection for three years, until September 30, 2006, before eliminating it.

Removing the grandfathering protection would ban all state and local taxes on Internet access. In its cost estimates for H.R. 49 and S. 150, the Congressional Budget Office (CBO) determined that eliminating the grandfathering protection would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA, P.L. 104-4, 2 U.S.C. 1501-1571). Both bills would eventually prohibit the taxes on Internet access that are currently being collected in up to ten states and a few local jurisdictions in six states, totaling approximately $80 million to $120 million per year. This estimate alone exceeds the UMRA threshold of $59 million in 2003, in the case of H.R. 49, and $64 million in 2007 (adjusted annually for inflation), in the case of S. 150. CBO noted that additional state and local revenues could be lost if more telecommunications services and information content are redefined as Internet access.[6]

Definitions

The ITFA tax moratorium prohibits new taxes on Internet access and multiple or discriminatory taxes on electronic commerce. The Act's definition of Internet access and of discriminatory tax, in particular, have been the source of some concern and legal uncertainty for state and local governments, providers of new-technology Internet access service, telecommunications companies offering bundled communications and information services, supporters of federal and state universal service programs, and companies with "dot.com" subsidiaries.

Taxation of Internet Access. The taxation of Internet access most commonly refers to the application of state and local sales taxes to the monthly charge that subscribers pay for access to the Internet through Internet service providers (ISPs) such as America Online (AOL), Microsoft Network (MSN), or EarthLink. Some examples can help illustrate the size of the tax burden at issue. If the tax were levied at a combined state and local sales tax rate of 7%, the tax on a dial-up modem service costing $22 per month would be $1.54 per month or $18.48 per year. On a cable modem service costing $40 per month, the tax would be $2.80 per month or $33.60 per year. On DSL (digital subscriber line) service costing $55 per month, the tax would be $3.85 per month or $46.20 per year.[7]

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[6] Congressional Budget Office, Cost Estimate for H.R. 49, Internet Tax Nondiscrimination Act, as ordered reported by the House Committee on the Judiciary on July 16, 2003, Washington, July 21, 2003, and Cost Estimate for S. 150, Internet Tax Nondiscrimination Act, as ordered reported by the Senate Committee on Commerce Science, and Transportation on July 31, 2003, Washington, September 9, 2003. Available on the Web at [http://www.cbo.gov], visited October 8, 2003, and in the LIS (Legislative Information Service) entry for each bill under CBO Cost Estimates.

[7] Monthly prices from 2003 Internet Service Provider (ISP) Directory, *Washington Post*, Sunday, February 2, 2003, p. H10. Common state-local sales tax rate selected from

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Bundling of Services. 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 concern on the part of state and local revenue departments that the tax-protection of Internet access may extend to "bundled" products and services that might otherwise be taxable if purchased on their own. This could include data and information services, cable television, books, magazines, games, music, video on demand, and Internet telephony. These types of products and services can be offered online and sold together with Internet access service.

Link to Telecommunications. There is concern on the part of telecommunications carriers that Internet access offered through some technologies, such as DSL or wireless services, might not be treated as exempt, while access offered over other technologies, such as dial-up telephone lines and cable modem, is exempt. In an attempt to make the tax exemption neutral across the various technologies delivering Internet access, both H.R. 49 as passed by the House and S. 150 as ordered reported by the Senate Commerce Committee would provide that all forms of telecommunications services used to provide Internet access would be exempt from state and local taxes.

State and local governments are concerned that this language could also exempt from tax the underlying telephone and cable services used to provide Internet access, which heretofore have remained subject to state and local tax under the current ITFA law. While not quantifying the likely cost, in its cost estimates of H.R. 49 and S. 150 CBO indicated that the expected negative effect on state and local revenues from not taxing the underlying telecommunications service would be considered an intergovernmental mandate.

Senators Allen and Wyden (cosponsors of the amendment in the nature of a substitute to S. 150 approved by the Senate Commerce Committee) have agreed to further refine the definition of Internet access before S. 150 reaches the Senate floor. They seek to clarify that the moratorium is on taxation of Internet access and not the underlying telecommunications services and that it is neutral with respect to the technology delivering the access.

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[7] (...continued)
Federation of Tax Administrators, Comparison of State and Local Retail Sales Taxes, January 2003. Available online at [http://www.taxadmin.org/fta/rate/sl_sales.html], visited October 8, 2003. Calculation of sample tax bills by CRS.

Funding Universal Service. Member of Congress are concerned about protecting the financing source for the Universal Service Fund (USF).[8] The USF is administered by the Universal Service Administrative Company, an independent not-for-profit organization under the auspices of the Federal Communications Commission (FCC). The USF is financed by mandatory contributions from interstate telecommunications carriers.[9] A company's USF contribution is a percentage[10] of its interstate and international end-user revenues. Some states also levy charges on the intrastate retail revenues of telecommunications carriers for their state's universal service fund.[11]

Supporters of the universal service programs are concerned that efforts to protect Internet access and associated telecommunications services from tax not be allowed to reduce the funding base for universal service. S. 150 as reported by the Commerce Committee states that the ITFA does not prevent the federal government or the states from imposing or collecting the fees or charges on telecommunications that are used to finance the universal service program codified (in 1996) by Section 254 of the Communications Act of 1934. At the Commerce Committee markup of S. 150 on July 31, 2003, Chairman McCain agreed to hold a hearing on the future of the Universal Service Fund.

Multiple Taxes. In order to eliminate the possibility of double taxation, 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 one city) from imposing a tax on the same transaction — unless a credit is offered for taxes paid to another jurisdiction. However, the state, county, and city in which an electronic commerce transaction takes place could all levy their sales tax on the transaction. There has not been much controversy over this definition.

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[8] The USF subsidizes telephone service to low income consumers and to high-cost rural and insular areas. Through the E-rate or education-rate program instituted by the Telecommunications Act of 1996, the USF also subsidizes telecommunications discounts for schools and libraries. Also as a result of the 1996 Act, the USF subsidizes communications links between rural health care providers and urban medical centers. For further information on the E-rate program, See CRS Issue Brief IB98040, *Telecommunications Discounts for Schools and Libraries: The "E-Rate" Program and Controversies*, by Angele A. Gilroy.

[9] All telecommunications providers that provide service between states must contribute to the USF. This includes long distance companies, local telephone companies, wireless telephone companies, paging companies, and payphone providers.

[10] The percentage, know as the contribution factor, is set quarterly, and varies depending on the financing needs of the universal service programs. The federal universal service contribution factor for the third quarter of 2003 was 0.095 or 9.5%. The proposed contribution factor for the fourth quarter of 2003 was 0.092 or 9.2%. Federal Communications Commission, Contribution Factors & Quarterly Filings. Available online at [http://www.fcc.gov/wcb/universal_service/quarter.html], visited October 8, 2003.

[11] State charges are typically levied on the intrastate retail revenues of wireline carriers and, in some states, wireless carriers as well.

Discriminatory Taxes. In practice, the ban on discriminatory taxes on electronic commerce means that transactions arranged over the Internet are to be taxed in the same manner as mail order or telephone sales. 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.[12] (A use tax is the companion tax to the sales tax, applicable to interstate sales.) Congress or the Supreme Court would need to act to grant or approve the states' ability to require out-of-state tax collection, whether the transaction was arranged over the Internet or by mail-order, telephone, or other means.

The second part of the ITFA's definition of discriminatory tax lists conditions under which a remote seller's use of a computer server, an Internet access service, or online services does not establish nexus. These circumstances 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 processing of orders through the out-of-state computer server of a provider of Internet access service or online services. 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 or dot-com subsidiaries. The businesses claim that these Internet-based operations are free from sales and use tax collection requirements. Critics object that these methods of business organization are an abuse of the definition of discriminatory tax.

Streamlined Sales Taxes and Remote Collection Authority

In the 106th and 107th Congresses, a major controversy surrounding the bills to extend the original Internet tax moratorium involved the states' quest for sales and use tax collection authority. The issue was whether or not Congress was willing to indicate its willingness to eventually grant states the authority to require remote (out-of-state) sellers to collect use taxes on interstate sales. To possibly earn that authority, states would need to simplify their state and local sales and use tax systems to an acceptable degree.

Under current law, sellers with substantial nexus (defined as physical presence) in a state are already required to collect state (and local) tax on their sales arranged over the Internet (or by telephone, mail order, or other means) to customers in that state. In-state sellers are required to collect sales taxes from the buyer. Out-of-state sellers with a physical presence in the state (such as a warehouse or retail store) are required to collect use taxes from the buyer. (A use tax is complementary to a sales tax. It is levied on purchases made outside the state for use within the state.) In contrast, out-of-state sellers without nexus in the state are not required to collect the use tax. Some of these sellers may collect use tax voluntarily. If the out-of-state seller does not collect the use tax, it is technically the buyer's obligation to pay the

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[12] For additional discussion, see CRS Report RS20577, *State Sales Taxation of Internet Transactions*, by John R. Luckey.

tax to his home state. In practice, however, use tax compliance by non-business purchasers is low.

Aware of this low consumer compliance, many 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 catalog, telephone, or other means. Whether or not there is an Internet tax moratorium, separate congressional action would be needed in order for states to obtain the authority to require remote sellers to collect use taxes from customers at the time of the sale.

In its 1967 *National Bellas Hess*[13] decision, and again in its 1992 *Quill* decision,[14] 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 the state and local sales tax systems imposed an undue burden on interstate commerce.

Acknowledging administrative complexity as a major obstacle to remote collection, the states began a serious effort at state and local sales and use tax simplification through the Streamlined Sales Tax Project (SSTP). The project commenced in March 2000, midway through the initial ITFA moratorium (October 1998 - October 2001). The SSTP continued its work after the moratorium was extended in November 2001. On November 12, 2002, 34 states and the District of Columbia approved a model interstate agreement to simplify their sales tax systems, known as the Streamlined Sales and Use Tax Agreement. The agreement establishes uniform definitions for taxable goods and services. It would require participating states and local governments to have only one statewide tax rate for each type of product effective in 2006. Each state would retain the power to determine which products are taxed or exempt and the rate of tax for the state. The agreement provides for streamlined tax administration and audit requirements for sellers.

During their 2003 sessions, individual state legislatures considered legislation to bring their own state and local sales tax laws into conformity with the model tax agreement. For the agreement to come into effect, at least 10 states representing at least 20% of the combined population of the 45 states with a state sales tax were required to petition for membership into the agreement and be found to be in conformance with the agreement. (There is some question about whether in order to qualify as conforming 10 states must simply approve the agreement or must actually change the administration of their sales tax system to conform with the agreement.) As of July 18, 2003, 20 states had enacted legislation conforming with all or part of the agreement.[15] These 20 states represent approximately 30% of the population of

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

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

[15] Streamlined Sales Tax Project, State Legislative Status of Streamlined Sales and Use Tax Agreement (As of July 7, 2003). Available online at [http://www.streamlinedsalestax.org]

(continued...)

states with sales taxes. The Streamlined Sales Tax Implementing States (SSTIS) are scheduled to meet in November 2003 to confirm whether these states have met the required conformity.

Separately, a coalition of a few nationwide sellers reached agreements with 38 states and the District of Columbia to begin collecting their use tax voluntarily, starting February 3, 2003, in exchange for amnesty on previously uncollected taxes. Among the retailers participating initially were Wal-Mart Stores Inc., Target Corp., and Toys R Us Inc. Other retailers have entered into similar voluntary agreements.

In the 106th and 107th Congresses, bills were introduced that enumerated criteria for a simplified sales and use tax system and procedures for Congress to grant tax collection authority — in conjunction with an extension of the moratorium. In the 108th Congress, the sales tax issue is being pursued separately from the moratorium. H.R. 3184 (Istook and Delahunt) would grant states that comply with the Streamlined Sales and Use Tax Agreement the authority to require remote sellers to collect state and local use taxes on interstate sales.

The chairmen of the committees of jurisdiction in both the House and Senate have said that they want to pursue the moratorium extension independently from the sales tax issue. Representative Cannon, Chairman of the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee, and Senator McCain, Chairman of the Senate Committee on Commerce, Science, and Transportation, each indicated that their committee would hold a hearing on the sales tax issue, in addition to the hearing held on the moratorium extension. The House Subcommittee on Commercial and Administrative Law held an oversight hearing on October 1, 2003, titled "The Streamlined Sales Tax Agreement: States' Efforts to Facilitate Sales Tax Collection from Remote Vendors."

Business Activity Tax (BAT) Nexus Standards

The possibility that states could be authorized to require remote sellers to collect sales and use taxes on interstate sales, without requiring physical presence to establish nexus, has raised a concern that states would also try to impose their income and other business taxes on those sellers. More generally, there is interest on the part of some multistate businesses in having Congress clarify the determinants of nexus for state and local business activity taxes (BATs). (Business activity taxes are commonly thought of as corporate income taxes, but may also include franchise taxes, business license taxes, business and occupation taxes, apportionable gross receipts taxes, value-added taxes, single business taxes, and capital stock taxes.)

Some business organizations would like the nexus standard for BATs to be physical presence, in contrast to economic presence. The issue before Congress is whether and how to codify in federal law conditions that would or would not establish the nexus required for a state to be able to impose its business activity taxes

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[15] (...continued)
under St. Legislative Status. Updated by phone by the National Conference of State Legislatures (NCSL), on July 18, 2003.

(BAT) on a company located outside the state but involved in certain types of business activities within the state.

Representatives of state and local governments generally object that enacting the proposed nexus guidelines would seriously restrict the ability of states to levy their corporate income taxes (or other BATs) on business activities being conducted in their state by companies located in other states. In some states, the current basis for BAT nexus is economic presence. Even in states where physical presence is the standard, the criteria currently applied may differ substantially from the rules in proposed legislation.

To help keep the BAT nexus issue separate from the sales tax issue, the bills in earlier Congresses that addressed streamlined sales taxes and remote collection authority typically provided that a business's being required to collect sales and use taxes from customers from other states would not imply an obligation to pay business activity taxes to those other states. In the 108th Congress, H.R. 3184, which addresses sales and use taxes, contains a limitation section, with an intent similar to this provision in prior bills. However, there is still interest among supporters of codifying BAT nexus standard in including those provisions as part of the sales tax simplification legislation.

Thus far in the 108th Congress, BAT nexus is being addressed separately from both the extension of the Internet tax moratorium and the sales tax simplification issue. H.R. 3220 (Goodlatte and Boucher) would establish physical presence as the nexus standard for business activity taxes. It would enumerate criteria and exemptions thereto.

Action in Congress

Four bills to extend the Internet tax moratorium have been introduced in the first session of the 108th Congress. H.R. 49 was amended and reported by the House Judiciary Committee on July 16, 2003, and approved by the House on September 17. S. 150 was amended and reported by the Senate Commerce Committee on July 31 and was sequentially referred to the Finance Committee on September 29 for up to 30 days. S. 52 (Wyden) was the companion bill to H.R. 49 (Cox) as introduced. H.R. 1481 (Lofgren) is the only bill that would extend the current moratorium temporarily, for five years.

Both H.R. 49 and S. 150 would make the moratorium permanent. H.R. 49 would immediately remove the grandfathering protection offered under current law to states that had Internet access taxes in place prior to October 1, 1998. S. 150 would remove the grandfathering after three years, on October 1, 2006. H.R. 49 and S. 150 would amend the definition of Internet access to make the tax moratorium apply regardless of the method of telecommunication by which Internet access is delivered. S. 150 clarifies that the ITFA does not prevent the collection of federal or state fees for the universal service program.

H.R. 49

The House Judiciary Committee, Subcommittee on Commercial and Administrative Law, held a hearing on H.R. 49 (Cox) on April 1, 2003. Subcommittee consideration and markup were held on May 22, 2003. A technical amendment in the nature of a substitute was approved by voice vote. H.R. 49 (amended) was forwarded to the full committee by voice vote.

Three other amendments were proposed but withdrawn in the subcommittee, with the hope by the sponsors that the issues they raised would be considered again. The Delahunt amendment addressed the interstate sales tax collection issue. Subcommittee Chairman Christopher B. Cannon had agreed at the April 1 hearing to hold a separate hearing on the sales tax collection issue. The Watt amendment addressed the tax protection for Internet access delivered in variously bundled service packages and for different forms of telecommunications used to access the Internet (e.g., DSL and wireless). Chairman Cannon agreed to work with Representative Watt on the effort to further define Internet access before the full committee took up the bill. The Baldwin amendment would have preserved the grandfathering protection.

On July 16, 2003, the House Judiciary Committee held a markup of H.R. 49 (as amended in the nature of a substitute). The Committee approved one amendment and defeated two others. The bill was then reported favorably to the full House. The two defeated amendments were both introduced by Representative Sheila Jackson Lee. One would have preserved the current grandfathering protection permanently. The other would have gradually eliminated the grandfathering protection, cutting the permitted state and local tax rates in half two years after enactment of the bill and eliminating the taxes entirely four years after enactment of the bill.

The amendment that was approved was introduced on a bipartisan basis by Representative Melvin Watt and Subcommittee Chairman Chris Cannon.[16] It was intended to provide technological neutrality in the exemption from taxes on Internet access, without regard to the means by which Internet access is delivered. The amendment would add to the definition of Internet access (in Section 1104(5) of the Internet Tax Freedom Act) the phrase shown below in bold type:

> (5) INTERNET ACCESS. — 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**, except to the extent such services are used to provide Internet access**.[17] [Emphasis added.]

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[16] The language of the Watt-Cannon amendment that was approved in the full Judiciary Committee was different from the Watt amendment introduced but withdrawn in the Subcommittee on Commercial and Administrative law.

[17] The highlighted phrase was also added to the definition of Internet access services in Section 1101(e)(3)(D) of the Internet Tax Freedom Act. This pertains to the exception to

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This amendment would protect from state and local taxes all forms of telecommunications services used to provide Internet access. Purportedly, it is intended to make Internet access service made available via DSL (digital subscriber line), wireless services, or satellite free from tax, just as Internet access service delivered via dial-up phone and cable modem has been. However, the language of the amendment could also free from tax the underlying telephone and cable services used to provide Internet access. These underlying telecommunications services may currently be taxed by state and local governments. Furthermore, with the removal of the grandfather clause that protects taxes on Internet access that were generally imposed and actually enforced prior to October 1, 1998, the tax moratorium might also be interpreted to include income and property taxes on Internet access providers, in addition to sales taxes.

In its cost estimate of July 21, 2003, the Congressional Budget Office (CBO) determined that H.R. 49, as ordered reported by the House Judiciary Committee, would impose an intergovernmental mandate. CBO estimated that repealing the grandfather clause would lead to revenue losses (on Internet access) totaling $80 million to $120 million per year for the group of approximately 10 states and several local governments in a few states that currently tax Internet access. This amount alone exceeds the threshold of $59 million in 2003 (adjusted annually for inflation) established by the Unfunded Mandates Reform Act (UMRA). In addition, amending the definition of Internet access (with the Watt amendment) could free from tax some telecommunications services used to provide Internet access that are otherwise subject to state and local taxes under current ITFA law.[18]

The presence of an unfunded intergovernmental mandate in excess of the threshold amount means that a point of order may be raised when the bill is considered on the House or Senate floor.[19]

H.R. 49 was brought to the House floor on September 17, 2003, under a suspension of the rules. This procedure, designed for not highly controversial bills, provides for an up-or-down vote with no floor amendments and requires a two-thirds

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[17] (...continued)
the moratorium for making communications for commercial purposes that include material harmful to minors, if access by minors is not restricted. The addition of the phrase keeps the definition of Internet access service similar to the definition of Internet access in the ITFA. However, in this section the phrase may be redundant, because under Section 1101(e)(2) both (A) a telecommunications carrier engaged in the provision of a telecommunications service, and (B) a person engaged in the business of providing an Internet access service, are not considered as making a communication of material for commercial purposes.

[18] Congressional Budget Office. *Cost Estimate for H.R. 49, Internet Tax Nondiscrimination Act, as ordered reported by the House Committee on the Judiciary on July 16, 2003*. Washington, July 21, 2003. Available on the Web at [http://www.cbo.gov] and on the LIS for H.R. 49 under CBO Cost Estimates.

[19] For 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.

vote. Although representatives of states with grandfathered Internet access taxes objected to the bill, the House passed H.R. 49 as reported by the Judiciary Committee by voice vote.[20]

S. 150

On July 16, 2003, the Senate Committee on Commerce, Science, and Transportation held a hearing on the Internet tax moratorium. Chairman John McCain indicated that he preferred that the legislation to extend the moratorium be independent from the sales tax simplification and collection issue. He said he expected to hold a separate hearing on the interstate sales tax issue later this year.

On July 31, 2003, the Senate Commerce Committee marked up S. 150 (Allen). An amendment in the nature of a substitute offered by Senator Allen and co-sponsor Senator Wyden was approved by voice vote. The amended bill was ordered reported favorably. However, Senators Allen and Wyden agreed to further refine the definition of Internet access before the bill reaches the Senate floor. On September 29, S. 150 was reported by the Commerce Committee (S.Rept. 108-155) and sequentially referred to the Finance Committee for a period of up to 30 days.

The first two sections of S. 150 as amended by the Commerce Committee are similar to H.R. 49 as passed by the House. The first section names the bill the Internet Tax Non-discrimination Act. The second section would permanently extend the moratorium, remove the grandfathering protection for existing taxes on Internet access, and make conforming amendments to remove the reference to grandfathered taxes elsewhere in the ITFA. It would add to the definitions of Internet access and Internet access services the phrase "...except to the extent such services are used to provide Internet access" following "telecommunications services," just as was added to H.R. 49 by the Watt-Cannon amendment in the House Judiciary Committee. Senators Allen and Wyden have agreed to refine the definition of Internet access to better reflect their intentions that it is Internet access that is protected from tax and not the underlying communications medium. They also intend that the moratorium be neutral with respect to whatever technology is used to provide Internet access.

In addition to the elements included in H.R. 49, S. 150 as ordered reported includes a third section that would continue to grandfather existing taxes on Internet access for three more years, until September 30, 2006. A fourth section of the bill clarifies that the ITFA does not prevent the federal government or the states from imposing or collecting the fees or charges on telecommunications that are used to finance the universal service program authorized by Section 254 of the Communications Act of 1934.

For reasons similar to those given above with respect to H.R. 49, in its cost estimate of September 9, 2003 for S. 150, the Congressional Budget Office determined that the bill as ordered reported by the Senate Committee on Commerce, Science, and Transportation would impose an intergovernmental mandate, beginning

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[20] Alison Bennett, House Passes Permanent Extension Of Existing Internet Tax Moratorium, *Daily Tax Report*, Bureau of National Affairs, No. 81, Sept. 18, 2003, p. GG-1.

in 2007, once the grandfathering protection was removed.[21] This means that a point of order could be raised when the bill is considered on the Senate floor.

Internet Tax Bills Introduced in the 108th Congress

Table 1 succinctly compares the bills to extend the Internet tax moratorium introduced thus far in the House of Representatives and **Table 2**, the bills introduced in the Senate. **Table 3** lists bills on Internet-related issues introduced in the House. Each bill is described in more detail in the subsequent text.

Table 1. Comparison of Internet Tax Bills in the House

Bill Number (Sponsor)	Extension of Moratorium	Grandfathering of Existing Internet Access Taxes	Other Issues
H.R. 49 (Cox) passed in the House by voice vote 9/17/03	Permanent	No	Extends exemption from Internet access taxes to all forms of telecommunications used to provide access.
H.R. 1481 (Lofgren)	5 years, until Nov. 1, 2008	Yes	—

[21] Congressional Budget Office, Cost Estimate for S. 150, Internet Tax Nondiscrimination Act, as ordered reported by the Senate Committee on Commerce Science, and Transportation on July 31, 2003, Washington, September 9, 2003. Available on the Web at [http://www.cbo.gov] and in the LIS (Legislative Information Service) entry for S. 150 under CBO Cost Estimates.

Table 2. Comparison of Internet Tax Bills in the Senate

Bill Number (Sponsor)	Extension of Moratorium	Grandfathering of Existing Internet Access Taxes	Other Issues
S. 52 (Wyden)	Permanent	No	—
S. 150 (Allen) as ordered reported by the Commerce Committee	Permanent	Until Sept. 30, 2006	Like H.R. 49, extends exemption from Internet access taxes to all forms of telecommunications used to provide access. Clarifies that the ITFA moratorium does not prevent collection of federal or state fees or charges used to finance the universal service program.

Table 3. Bills on Internet-Related Issues in the House

Bill Number (Sponsor)	Issue
H.R. 3184 (Istook)	Would grant states that comply with the Streamlined Sales and Use Tax Agreement the authority to require remote sellers to collect state and local use taxes on interstate sales, subject to minimum simplification requirements for the Agreement.
H.R. 3220 (Goodlatte and Boucher)	Would establish physical presence as the nexus standard for levying state and local business activity taxes on interstate commerce.

House of Representatives

H.R. 49 (Cox). Internet Tax Nondiscrimination Act. H.R. 49 would permanently extend the moratorium imposed by the Internet Tax Freedom Act. Would remove the grandfathering protection for taxes on Internet access that were generally imposed and actually enforced prior to October 1, 1998, by removing from the ITFA the grandfather clause and the definition of generally imposed and actually enforced taxes. Companion to S. 52 (Wyden). Introduced January 7, 2003; referred to Committee on Judiciary. Referred to Subcommittee on Commercial and Administrative Law on March 6, 2003. Hearing held on April 1, 2003. Subcommittee consideration and markup session held on May 22, 2003. A technical amendment in the nature of a substitute approved by voice vote. Three other amendments proposed but withdrawn in the subcommittee. H.R. 49 (amended) forwarded to the full committee by voice vote.

Full Judiciary Committee markup on July 16, 2003. Bipartisan amendment introduced by Representatives Watt and Cannon approved; amended the definition of Internet access intending to make the tax exemption technologically neutral; provided that all forms of telecommunications services used to provide Internet access would be exempt from Internet access taxes. Two amendments defeated, one to preserve the grandfathering and another to phase out the grandfathering in two stages. H.R. 49 (as amended in the nature of a substitute) ordered reported favorably by voice vote. Reported to the House on July 24, 2003, H.Rept. 108-234.

In its cost estimate of July 21, 2003, the Congressional Budget Office determined that H.R. 49 as ordered reported by the House Judiciary Committee would impose an intergovernmental mandate. H.R. 49 was brought to the House floor on September 17, 2003, under a suspension of the rules and was approved by voice vote.

H.R. 1481 (Lofgren). Internet Growth and Freedom Act of 2003. H.R. 1481 would temporarily extend the moratorium imposed by the Internet Tax Freedom Act by five years, until November 1, 2008. Would continue the grandfather protection for pre-existing Internet access taxes. Introduced March 27, 2003; referred to Committee on Judiciary.

H.R. 3184 (Istook and Delahunt). Streamlined Sales and Use Tax Act. H.R. 3184 would grant states that are parties to the Streamlined Sales and Use Tax Agreement, a multistate compact approved November 12, 2002, the authority to require remote sellers to collect and remit state and local sales and use taxes, even if the seller does not have physical presence in the taxing state. Enumerates 18 minimum simplification requirements that the Agreement must meet. Introduced September 25, 2003; referred to Committee on Judiciary.

H.R. 3220 (Goodlatte and Boucher). Business Activity Tax Simplification Act of 2003. H.R. 3220 would establish physical presence as the nexus standard for levying state and local business activity taxes on interstate commerce. Would amend P.L. 86-872, approved September 14, 1959, which limits the power of states to impose net income taxes on interstate commerce. Would generally require more than 21 days per calendar year of use of persons or property in a state to establish nexus.

Enumerates activities that would be exempt. Introduced October 1, 2003; referred to Committee on Judiciary.

Senate

S. 52 (Wyden). Internet Tax Nondiscrimination Act. S. 52 would permanently extend the moratorium imposed by the Internet Tax Freedom Act. Would remove the grandfathering protection for taxes on Internet access that were generally imposed and actually enforced prior to October 1, 1998, by removing from the ITFA the grandfather clause and the definition of generally imposed and actually enforced taxes. Companion to H.R. 49 (Cox). Introduced January 7, 2003; referred to Committee on Commerce, Science, and Transportation.

S. 150 (Allen). Internet Tax Non-discrimination Act of 2003. S. 150 would permanently extend the moratorium imposed by the Internet Tax Freedom Act. Would remove the grandfathering protection for taxes on Internet access that were generally imposed and actually enforced prior to October 1, 1998. Would remove the reference in the ITFA to the moratorium beginning on October 1, 1998. Would remove from the ITFA the definition of Internet access (which includes the grandfather clause) but would retain the definition of generally imposed and actually enforced taxes. Introduced January 13, 2003; referred to Committee on Commerce, Science, and Transportation.

Committee markup held July 31, 2003. Amendment in the nature of a substitute offered by Senators Allen and Wyden approved by voice vote. Amended bill ordered reported favorably. First two sections of S. 150 (as ordered reported) similar to H.R. 49 as reported by the House Judiciary Committee. First section renames the bill the Internet Tax Non-Discrimination Act. Second section would permanently extend the moratorium, remove the grandfathering protection for existing taxes on Internet access, and make conforming amendments to remove the reference to grandfathered taxes elsewhere in the ITFA. Would add to the definitions of Internet access and Internet access services, following "telecommunications services," the phrase "...except to the extent such services are used to provide Internet access."

In addition to the elements included in H.R. 49 as passed, S. 150 as ordered reported includes a third section that would continue to grandfather existing taxes on Internet access until September 30, 2006. A fourth section clarifies that the ITFA does not prevent the federal government or the states from imposing or collecting the fees or charges on telecommunications that are used to finance the universal service program authorized (in 1996) by Section 254 of the Communications Act of 1934.[22]

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[22] A "Preservation of Authority" clause with similar intent was detached from the ITFA when the second title was codified separately from the first title. The "savings clause" was included in the second title of S. 442 (105th Congress), the ITFA as passed by the Senate. The relevant clause was included as Section 1205 in Title XII of Division C of P.L. 105-277, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999: "Nothing in this title shall limit or otherwise affect the implementation of the Telecommunications Act of 1996 (P.L. 104-104) or the amendments made by such Act."
(continued...)

Senators Allen and Wyden agreed to refine the definition of Internet access to better reflect their intentions that it is Internet access that is protected from tax and not the underlying communications medium. They also intend that the moratorium be neutral with respect to whatever technology is used to provide Internet access.

In its cost estimate of September 9, 2003, the Congressional Budget Office determined that S. 150 as ordered reported by the Senate Committee on Commerce, Science, and Transportation found that currently up to ten states and a few local jurisdictions in six states collect taxes on Internet access. The bill would impose direct costs on state and local governments of these lost revenues totaling approximately $80 million to $120 million per year beginning in 2007, after the grandfathering protection was removed in October 2006. Because the estimate exceeds the threshold of $64 million for 2007 (adjusted annually for inflation), this would be an intergovernmental mandate.[23] This means that a point of order could be raised when the bill is considered on the Senate floor.

On September 29, S. 150 was reported by the Commerce Committee accompanied by S.Rept. 108-155, *Internet Tax Non-Discrimination Act of 2003*, report on S. 150. The bill was sequentially referred to the Finance Committee for a period of up to 30 calendar days, pursuant to a Senate order of September 23.

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[22] (...continued)
Note that the language referred to "this title," whereas the underlying bill, S. 442, had referred to "this Act," encompassing both titles. Title XI of Division C of P.L. 104-104 alone was called ITFA, and was codified as 47 U.S.C. 151 note. Title XII was codified separately as 19 U.S.C. 2241 note. The savings clause was thus separated from the main ITFA.

[23] Congressional Budget Office, Cost Estimate for S. 150, Internet Tax Nondiscrimination Act, as ordered reported by the Senate Committee on Commerce Science, and Transportation on July 31, 2003, Washington, September 9, 2003. Available on the Web at [http://www.cbo.gov] and in the LIS (Legislative Information Service) entry for S. 150 under CBO Cost Estimates.

For Additional Information

Hearings in the 108th Congress

U.S. Congress. House. Committee on the Judiciary. Subcommittee on Commercial and Administrative Law. *Internet Tax Nondiscrimination Act*. Hearing on H.R. 49. Serial No. 13. 108th Cong., 1st sess., April 1, 2003. Washington: GPO, 2003. 102 p. Available at [http://www.house.gov/judiciary].

U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Internet Tax Moratorium. Hearing. 108th Cong., 1st sess., July 16, 2003. Not yet published. Written testimony available at [http://commerce.senate.gov].

CRS Reports

CRS Electronic Briefing Book, *Taxation*, Internet Taxation, "Taxing Internet Transactions," available at [http://www.congress.gov/brbk/html/ebtxr70.html].

CRS Report RL31177, *Extending the Internet Tax Moratorium and Related Issues*, January 17, 2002, by Nonna A. Noto. (Addresses issues raised in the 107th Congress.)

CRS Report RL31252, *Internet Commerce and State Sales and Use Taxes*, by Steven Maguire.

CRS Report RL31158, *Internet Tax Bills in the 107th Congress: A Brief Comparison*, December 6, 2001, by Nonna A. Noto.