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CRS Report for Congress

Internet Taxation: Issues and Legislation

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Summary

Congress is involved in issues of state and local taxation of Internet transactions because commerce conducted by parties in different states over the Internet falls under the Commerce Clause of the Constitution. Currently, the "Internet Tax Moratorium" prohibits (1) new taxes on Internet access services and (2) multiple or discriminatory taxes on Internet commerce. The moratorium was created by the Internet Tax Freedom Act (ITFA) of 1998 (112 Stat. 2681) and has been extended twice. The original moratorium expired on October 21, 2001. Congress extended the moratorium through November 1, 2003, with the Internet Tax Nondiscrimination Act, P.L. 107-75. The moratorium was extended for an additional four years, through November 1, 2007, by the Internet Tax Nondiscrimination Act, P.L. 108-435. On October 31, 2007, P.L. 110-108, the Internet Tax Freedom Act Amendments Act of 2007 was passed extending the moratorium through November 1, 2014. Generally, taxes on Internet access that have continued in place since before October 1, 1998, are protected by a grandfather clause.

An issue previously raised in connection with the Internet tax moratorium concerned states streamlining their sales taxes in order to gain remote tax collection authority. In the 110th Congress, S. 34 and H.R. 3396 would grant states that comply with the Streamlined Sales and Use Tax Agreement the authority to require remote sellers to collect state and local taxes on interstate sales. Another related issue is whether and how to have Congress set the nexus standards under which a state is entitled to impose a business activity tax (BAT, e.g., corporate net income tax, franchise tax, business and occupation tax, gross receipts tax) on a company located outside the state, but with some business activities in the state. In the 110th Congress, S. 1726 and its twin H.R. 5267 would establish more-uniform standards — generally higher standards — for the level of business activity that would create nexus and thus state corporate income taxability. For more on state corporate income taxes, see CRS Report RL32297, *State Corporate Income Taxes: A Description and Analysis*, by Steven Maguire.

This report will be updated as legislative events warrant.

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Internet Taxation: Issues and Legislation

History

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...."

This initial Internet tax moratorium expired on October 21, 2001. The Internet Tax Nondiscrimination Act, P.L. 107-75, enacted on November 28, 2001, provided for a two-year extension of the prior moratorium, through November 1, 2003. The moratorium was extended for an additional four years, through November 1, 2007, by the Internet Tax Nondiscrimination Act, P.L. 108-435, enacted on December 3, 2004. Taxes on Internet access that were in place before October 1, 1998, were protected by a grandfather clause. The 2004 (P.L. 108-435) extension also grandfathered pre-November 1, 2003, taxes (mostly on digital subscriber line or DSL services) through November 1, 2005, and excluded from the moratorium taxes on voice or similar service utilizing voice over Internet protocol (VoIP). These services were not as prevalent at the time the original moratorium was enacted. As part of compromise negotiations in the 108th Congress, the grandfathering protection for Internet access taxes in Wisconsin was limited to three years (through November 1, 2006) instead of four, and the ability of Texas municipalities to collect franchise fees from telecommunications providers that use public lands was protected. The 2004 act included several modifications and refinements to the original ITFA. Specifically, the 2004 act:

- Extended the Internet tax moratorium for four years, retroactively one year to November 1, 2003, and forward three years until November 1, 2007. The moratorium barred state and local governments from imposing any new taxes on Internet access or imposing any multiple or discriminatory taxes on electronic commerce.

- Clarified that the term "tax on Internet access" applies regardless of whether the tax is imposed on a provider or buyer of Internet access.

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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.

- Made explicit that a "tax on Internet access" does not include a tax levied on net income, capital stock, net worth, or property value.

- Provided that the terms "Internet access" and "Internet access service" do "not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access." (This permits some portion of telecommunications services to be included under the tax moratorium.)

- Extended the grandfather protection from November 1, 2003, until November 1, 2007, for state and local governments which taxed Internet access prior to October 1, 1998. An exception was made for a state telecommunications service tax in Wisconsin, for which protection was extended only until November 1, 2006. Protection was extended only until November 1, 2005, for taxes on Internet access that were generally imposed and actually enforced as of November 1, 2003. This provision applies mainly to taxes on digital subscriber line (DSL) services.

- Explicitly protected the Texas municipal access line fee. This provision is intended to protect the ability of Texas municipalities to collect franchise fees from telecommunications providers that use public lands.

- Included a new accounting rule that charges for Internet access may be subject to taxation in cases where they are aggregated with charges for telecommunications services or other charges that are subject to taxation — unless the Internet access provider can reasonably identify the charges for Internet access.

- Stated that nothing in the act prevents the collection of any charges for federal or state universal service programs (for telephone service), or for state or local 911 and E-911 (emergency call) services, nor does it affect any federal or state regulatory non-tax proceeding (such as FCC regulatory proceedings).

- Clarified that the moratorium does not apply to taxes on Voice over Internet Protocol (VoIP) services. This section does not apply to services that are incidental to Internet access, such as voice-capable e-mail or instant messaging.

- And provided for the GAO (Government Accountability Office) to study the effects of the Internet tax moratorium on the revenues of state and local governments and on the deployment and adoption of broadband technologies for Internet access throughout the United States, including under-served rural areas. The study was to compare deployment in states that tax broadband Internet access service with states that do not. The Comptroller General was to report the findings, conclusions, and any recommendations from the study to the Senate Committee on Commerce, Science, and Transportation and the House Committee on Energy and Commerce by November 1, 2005. The report was published in January 2006.[2]

Issues

The five main issues surrounding Internet taxation and e-commerce that Congress may address before the 2014 expiration are as follows:

- whether or not to extend the moratorium on Internet access taxes and if so, temporarily or permanently;`
- whether, if the moratorium were to be extended, to continue to grant grandfather protection for states that imposed taxes on Internet access before the original moratorium was enacted;
- how to better define Internet access and discriminatory taxes to the satisfaction of all stakeholders;
- whether to grant states the authority to require remote sellers to collect use taxes if the states adopted a streamlined sales tax system; and
- if congressional codification of guidelines is needed 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, franchise tax, business license tax) liability.

These issues remain similar to those considered in 2004 and 2007, the two most recent times the Internet tax moratorium was temporarily extended. Growth in Internet technology and electronic commerce, however, may generate new policy questions before 2014.

The Moratorium: Permanent vs. Temporary Extension?

The intent of the Internet Tax Freedom Act (enacted in 1998) was to prevent state taxes on Internet access, to ensure that multiple jurisdictions could not tax the same electronic commerce transaction, and to ensure that commerce over the Internet would not be singled out for discriminatory tax treatment. Supporters of extending the moratorium contend that the Internet should continue to be protected from the administrative and financial burdens of taxation in order to further advance of Internet technology and associated economic activity.[3] Opponents of extending the

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[2] U.S. Government Accountability Office, *Internet Access Tax Moratorium: Revenue Impacts Will Vary by State*, GAO-06-273, Jan. 2006.

[3] U.S. Congress, Committee on Commerce, Science, and Transportation, *Internet Tax Non-*
(continued...)

moratorium contend that a federal moratorium infringes on the states' independent authority to levy taxes and, further, that Internet transactions and services should not be afforded preferential tax treatment.

Supporters of permanent extension of the moratorium maintain it would eliminate the need for Congress to revisit the issues surrounding Internet taxation when a temporary moratorium expires. Permanent extension presumably could also provide both the producers and consumers of Internet services greater certainty about state and local taxation of the Internet. Opponents, on the other hand, say a permanent extension would not address the underlying issue of federal restrictions on state taxation, nor would it clarify the definition of Internet access.

Opponents of a permanent extension of the moratorium point out that a temporary one would allow Congress to periodically review the conditions of the moratorium and the effect of the moratorium on the states. Reassessment could then be made in the context of developments in computer technology and business organization, as well as state and local government tax administration. A temporary extension could also provide more time for the states to further simplify their sales and use taxes. (See the discussion below on *Streamlined Sales Taxes and Remote Collection Authority*.)

Allowing the moratorium to sunset would permit states to tax Internet access, although, in practice, the trend has been for states to repeal their Internet access taxes. As Internet technology continues to change the telecommunications industry, however, state and local governments will likely modify how the industry is taxed. A sunset of the moratorium could induce states to address the taxation of telecommunications more broadly.

Grandfathering of Existing Access Taxes

The Internet Tax Freedom Act exempted 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 already applying their sales tax to Internet access services.[4] Subsequently, Connecticut, Iowa, Tennessee, 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. These developments left six states imposing a sales tax (or equivalent tax) on Internet access as of January 2006: New Mexico, North Dakota, Ohio (on commercial use only), South Dakota, 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

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[3] (...continued)
Discrimination Act of 2003, report to accompany S. 150, 108th Cong., 1st sess., S.Rept. 108-155, (Washington: GPO, 2003), p. 1.

[4] National Conference of State Legislatures, "Which States Tax Internet Access?" March 25, 1998.

[5] Vertex, Inc., *Tax Cybrary*. Available at [http://www.vertexinc.com], visited July 7, 2008.

two-way communications equipment), and Washington State its business and occupation tax (a gross receipts tax levied on business) on Internet access. The Congressional Budget Office believes that several *local* jurisdictions in Colorado, Ohio, South Dakota, Texas, Washington, and Wisconsin also are collecting taxes on Internet access.[6]

The grandfathering protection was continued when the ITFA moratorium was extended for two years in 2001 (through November 1, 2003). The act further extended the grandfathering protection for pre-October 1998 taxes through November 1, 2007. A second grandfathering issue arose in 2004 as states began to tax Internet access provided through digital subscriber lines (DSL), a high-speed telephone service. DSL is considered a telecommunication service and was exempt from the original moratorium and thus taxable. ITFA grandfathered pre-November 2003 taxes (mostly taxes on DSL service) through November 1, 2005. The last extension discontinued the grandfathering protection for grandfathered states that had repealed or stopped enforcing collection of the sales tax on Internet access services.[7]

In its cost estimates for H.R. 49 and S. 150 in the 108th Congress, the Congressional Budget Office (CBO) determined that eliminating the grandfathering protection for Internet access taxes would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA, 2 U.S.C. 1501-1571).[8] According to CBO, the prohibition of taxes on Internet access that were then collected in *up to* 10 states (in 2003, at the time of the CBO study, more states had Internet access taxes) and a few local jurisdictions in six states, would cost these jurisdictions approximately $80 million to $120 million per year. This estimate alone exceeded 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 were redefined as Internet access.

Definitions

As noted earlier, the ITFA tax moratorium prohibits new taxes on Internet access and multiple or discriminatory taxes on electronic commerce. The act's definitions 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

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[6] Congressional Budget Office, "Cost Estimate for S. 150, the Internet Tax Nondiscrimination Act," Sept. 9, 2003. Contained in U.S. Congress, Senate, Committee on Commerce, Science, and Transportation, *Internet Tax Non-discrimination Act of 2003*, Report on S. 150, 108th Cong., 1st sess., Report 108-155, Sept. 29, 2003 (Washington: GPO, 2003), p. 7. Cost estimate also available at [http://www.cbo.gov].

[7] Sec. 6 of P.L. 110-108.

[8] 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, the Internet Tax Nondiscrimination Act." Both available at [http://www.cbo.gov].

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 and use taxes to the monthly charges that retail subscribers pay for access to the Internet. These payments may go to traditional dial-up Internet service providers (ISPs) or to the local telephone or cable TV company. According to the Federation of Tax Administrators, the tax may also take the form of a sales and use tax or excise tax levied specifically on telecommunications, information services, or data processing services, the definition of which encompasses "charges for Internet access." P.L. 108-435 clarified that a "tax on Internet access" applies regardless of whether the tax is imposed on a provider or buyer of Internet access.[9] P.L. 110-108 further refined the definition of Internet access to include "homepage, electronic mail and instant messaging" services.[10]

Telecommunications Industry Concerns. Telecommunications carriers were concerned that Internet access offered through primarily telecommunications technologies, such as DSL or wireless services, might not be treated as exempt from tax, while access offered over other technologies, such as cable modem, would be exempt. In an attempt to address these concerns, both P.L. 110-108 and P.L. 108-435 provided that all forms of telecommunications services used to provide Internet access would be exempt from state and local taxes under the moratorium.[11]

State and Local Government Concerns. Before enactment of P.L. 108-435, state and local governments were concerned that the tax moratorium could be interpreted to go far beyond retail Internet access. Ultimately, P.L. 108-435 made explicit that the term "tax on Internet access" would not include a tax levied on net income, capital stock, net worth, or property value. It extended the grandfather protection for existing Internet access taxes until November 1, 2007, with the exception of Wisconsin, where protection ended on November 1, 2006. It explicitly protected the Texas municipal access line fee; this protects the ability of Texas municipalities to collect franchise fees from telecommunications providers that use public lands. P.L. 110-108 clarified further the types of taxes that were outside of the moratorium.

In addition, state and local governments were concerned that with the growth of Internet telephony (Voice over Internet Protocol, VoIP), there would be less traditional telephone service or plain old telephone service (POTS) remaining in the tax base. Currently, state and local taxes on voice telephone services produce $12

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[9] A recent GAO (*op. cit.* Jan. 2006, p. 23) report concluded that ISP acquired services are not protected by the moratorium.

[10] See Section 4(2) of P.L. 110-108.

[11] For more information, see U.S. Congress, Senate Committee on Commerce, Science, and Transportation, *Internet Tax Non-discrimination Act of 2003*, Report on S. 150,108th Cong., 1st sess., S.Rept. 108-155, Sept. 29, 2003 (Washington: GPO, 2003).

billion in annual revenues.[12] P.L. 108-435 and P.L. 110-108 both clarified that the tax moratorium does not apply to VoIP services, which may be taxed.[13]

Bundling of Services. The breadth of coverage in the first sentence of the definition of Internet access shown above 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. These could include data and information services, cable television, books, magazines, games, music, and video on demand, for example. These types of products and services can be offered online and sold as part of an Internet access service.[14]

P.L. 108-435 included a new accounting rule which addressed the bundling issue. Under this rule, Internet access service may be taxable if access fees are aggregated with fees for otherwise-taxable telecommunications services. If the Internet access provider can reasonably identify the charges for Internet access, then the Internet access, however, is not taxable.

Funding Universal Service. Some Members of Congress were concerned about protecting the financing source for the Universal Service Fund (USF).[15] The USF is administered by the Universal Service Administrative Company, an independent not-for-profit organization operating under the auspices of the Federal Communications Commission (FCC). The USF is financed by mandatory contributions from interstate telecommunications carriers.[16] A company's USF contribution is a percentage of its interstate and international end-user revenues.[17]

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[12] Michael Mazerov, "A Permanent Ban on Internet Access Taxation Risks Serious Erosion of State and Local Telephone Tax Revenue as Phone Calls Migrate to the Internet," Center on Budget and Policy Priorities, Washington, DC, Feb. 11, 2004, p. 1. Available at [http://www.cbpp.org/2-11-04sfp.pdf], visited July 7, 2008.

[13] For objections to a tax prohibition on VoIP, see Michael Mazerov, "Proposed 'Voice over Internet Protocol Regulatory Freedom Act' Threatens to Strip States and Localities of Billions of Dollars in Annual Tax Revenues," Center on Budget and Policy Priorities, Washington, DC, July 20, 2004. Available at [http://www.cbpp.org/7-20-04tax.pdf], visited July 7, 2008.

[14] Harley Duncan and Matt Tomalis, "On the Internet Tax Freedom Act: The Forgotten First Sentence," *State Tax Notes*, March 29, 2004, pp. 1105-1108.

[15] 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 Report RL32018, *The E-Rate Program: Universal Service Fund Telecommunications Discounts for Schools*, by Angele A. Gilroy.

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

[17] The percentage, known as the contribution factor, is set quarterly, and varies depending
(continued...)

Some states also levy charges on the intrastate retail revenues of telecommunications carriers for their state's universal service fund.[18]

Supporters of the universal service programs were concerned that efforts to protect Internet access and associated telecommunications services should not reduce the funding base for universal service. The moratorium 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. Nor does it prevent states or local governments from collecting fees or charges to support 911 or E-911 (emergency) services. Nor does it affect any federal or state regulatory proceeding that is not related to taxation.

Multiple Taxes. 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 taxes on the transaction.

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.[19] (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

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[17] (...continued)
on the financing needs of the universal service programs. The proposed contribution factor for the third quarter of 2008 is 0.114 or 11.4%. Federal Communications Commission, Contribution Factors and Quarterly Filings, available at [http://www.fcc.gov/omd/contribution-factor.html], visited June 23, 2008.

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

[19] For additional discussion, see CRS Report RS21537, *State Sales Taxation of Internet Transactions*, by John R. Luckey.

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 earlier Congresses, the debate surrounding legislation to extend the Internet tax moratorium was linked to the states' quest for sales and use tax collection authority. The issue continues to be whether Congress is willing to grant states the authority to require remote (out-of-state) sellers to collect use taxes on interstate sales conditioned on a simplification of state and local sales and use tax systems. Bills were introduced in conjunction with an extension of the moratorium that enumerated criteria for a simplified sales and use tax system, and procedures for Congress to grant tax collection authority. In contrast, in the 108th Congress and continuing into the 109th and 110th Congress, the sales tax issue has been pursued separately from the moratorium.

Remote Collection Issue. Under current law, a vendor with substantial nexus (usually defined as physical presence) in its customer's state collects the state (and local) sales tax on sales arranged over the Internet (or by telephone, mail order, or other means). In contrast, an out-of-state vendor without substantial nexus in the customer's state is not required to collect the sales tax.[20] Technically, the customer is required to remit a "use" tax to his or her state of residence.[21] In practice, however, use tax compliance by non-business purchasers is low. Because of this low compliance, many states have long wanted to require out-of-state vendors without physical presence in the respective states (referred to as remote sellers) to collect the use tax from the customer. This would apply to all interstate sales, whether arranged over the Internet or by mail-order catalog, telephone, or other means.

The Streamlined Sales and Use Tax Agreement (SSUTA). Acknowledging administrative complexity as a major obstacle to remote collection authority, the states began a concerted effort to simplify state and local sales and use tax through the Streamlined Sales Tax Project (SSTP).[22] The project commenced in March 2000, midway through the initial ITFA moratorium (October 1998 - October 2001). As of February 27, 2008, 17 states were designated as "full" members for having approved a model interstate agreement to simplify their sales tax systems,

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[20] In 1967 and again in 1992, the Supreme Court invited the Congress to take action on this issue. See the following decisions: *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[21] The use tax is the companion tax to the sales tax, created to ensure that cross-border transactions are not favored in the state tax code.

[22] For more on the Streamlined Sales and Use Tax Agreement, see CRS Report RL34211, *State and Local Taxes and the Streamlined Sales and Use Tax Agreement*, by Steven Maguire.

known as the Streamlined Sales and Use Tax Agreement (SSUTA).[23] The agreement establishes uniform definitions for taxable goods and services and requires that a participating state and local government have only one statewide tax rate for each type of product. Another five states are "associate" members for partially complying with the SSUTA. Each state would retain the power to define which products are taxable and establish its tax rate.

In the 110th Congress, S. 34 (Enzi) and H.R. 3396 (Delahunt) would grant states that comply with the SSUTA the authority to require remote sellers to collect state and local use taxes on interstate sales.

Business Activity Tax (BAT) Nexus Standards

The possibility that states could be authorized to require remote vendors to collect sales and use taxes on interstate sales raised concerns that states would then attempt to impose income and other business taxes on those vendors. In response, some multistate businesses asked Congress to clarify nexus standards for state and local business activity taxes (BATs).[24] Past court decisions and the landmark P.L. 86-272, enacted in 1959 (15 U.S.C. 381 et seq.), clarified nexus by identifying those activities which would *not* establish nexus. Generally, soliciting the sale of tangible goods in a state for shipment by common carrier from locations outside the state would not be sufficient to trigger nexus.

Proponents of federally defined nexus standards contend that current federal law does not sufficiently define substantial nexus. The issue before Congress is whether to codify nexus rules for intangible property and services, not just tangible goods as provided for in P.L. 86-272. Currently, each state independently implements rules that establish nexus for economic activities that are not covered by P.L. 86-272. Although state rules are very similar for many services and activities, there is still significant variation among states on the threshold for establishing nexus. In theory, Congress could establish uniform federal standards for imposing state business activity taxes on out-of-state businesses.

Some representatives of state and local governments, however, are concerned that enacting federal nexus guidelines could restrict their ability to levy corporate income taxes or other BATs on business activities conducted in their state. For example, if Congress implemented thresholds at the midpoint level of all existing state nexus rules, by definition, many states would lose taxpayers that did not meet

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[23] The states are: Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, West Virginia, and Wyoming. Available at: [http://www.streamlinedsalestax.org/Legislation_status/Index.html], visited June 30, 2008.

[24] Business activity taxes are commonly thought of as corporate income taxes, but may also include franchise taxes, business license taxes, business and occupation taxes, a tax on gross receipts, gross income or gross profits, value-added taxes, single business taxes, and capital stock taxes. They do not include taxes on transactions, like sales and use taxes or excise taxes. For more on state corporate income taxes, see CRS Report RL32297, *State Corporate Income Taxes: A Description and Analysis*, by Steven Maguire.

the new standard for substantial nexus. The states with the lowest nexus thresholds would fare the worst under such a scenario. Perhaps more importantly,"bright line" legislation would expand the definition of economic activity beyond tangible goods to include intangible goods and services.

The remote collection authority bills offered in earlier Congresses typically provided that out-of-state vendors that collected sales and use taxes would not then be subject to business activity taxes by virtue of their tax collection for the state.[25] In the 110th Congress, the BAT nexus issue had been kept separate from both the extension of the Internet tax moratorium and the sales tax simplification issue.

Action in the 110th Congress

Internet Tax Moratorium Legislation

On October 31, 2007, P.L. 110-108, the Internet Tax Freedom Act Amendments Act of 2007, was passed extending the moratorium through November 1, 2014. Generally, taxes on Internet access that have continued in place since before October 1, 1998, are protected by a grandfather clause.

Internet-Commerce-Related Legislation

SSUTA. In the Senate, S. 34 (Senator Enzi) and H.R. 3396 (Senator 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 taxes on interstate sales. H.R. 3396 has 10 cosponsors and S. 34 has three cosponsors.

BAT Nexus. A proposal to address state business activity taxation has also been introduced in the 110th Congress. S. 1726 (Senator Schumer and Senator Crapo) and its companion H.R. 5267 (Representative Boucher and Representative Goodlatte) would establish a physical presence standard for business activity taxes and expand the test to include intangible goods and services. More specifically, they would (1) amend P.L. 86-272 to extend to all sales (not just tangible personal property) and to other state and local business activity taxes (not just net income taxes) the protection from taxation on interstate commerce if the only activity within a state was soliciting orders for sales; (2) establish physical presence as the nexus standard for levying state and local business activity taxes on interstate commerce; and (3) generally require use of employees or property in a state for more than a combined 15 days per calendar year to establish nexus. In addition, the legislation would provide a de minimus standard for firms whose physical presence is "limited or transient."[26]

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[25] For more on state BATs, see CRS Report RL32297, *State Corporate Income Taxes: A Description and Analysis*, by Steven Maguire.

[26] Sec. 3(b)(2).