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Taxing Internet Transactions

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The Internet Tax Freedom Act (ITFA) was enacted as part of the Omnibus Consolidation and Emergency Supplemental Appropriations Act, P.L. 105-277. The Act imposed a 3-year moratorium on new Internet taxation and established the Advisory Commission on Electronic Commerce (ACEC, the commission) in October of 1998. The final report of the commission, presented in April 2000, is available on the ACEC web page. The Internet tax moratorium prohibits the taxation of Internet access and the multiple or discriminatory taxation of Internet commerce. In the 107th Congress, the moratorium was extended through November 1, 2003 (the moratorium has expired) by the Internet Tax Nondiscrimination Act, P.L. 107-75. The moratorium does not preclude states from requiring vendors with substantial nexus in the state from collecting sales and use taxes on products purchased over the Internet. However, the moratorium would preclude state and local governments from levying taxes on Internet access services. The appropriate definition of Internet access as been the subject of significant debate in Congress.

Current Issues

The Moratorium. On January 7, 2003, Senator Wyden and Representative Cox introduced identical legislation, S. 52 and H.R. 49 respectively, that would make the Internet tax moratorium permanent. In addition, S. 52/H.R. 49 would repeal the grandfather clause in the ITFA that allows states that imposed taxes on Internet access taxes at the time of ITFA passage to continue collecting the tax. The states that are collecting Internet access taxes would then lose that revenue source. At a recent Hearing on H.R. 49, the Federation of Tax Administrators (FTA) testified that "...nine states currently impose taxes that are protected -- New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, and Wisconsin." In the same testimony, FTA argues that "...repealing the preemption would constitute an intergovernmental mandate under the Unfunded Mandate Reform Act." The Congressional Budget Office estimates that H.R. 49 would impose an intergovernmental mandate on state an local governments that would cost between $80 million and $120 million for those states that were taxing Internet access before the original moratorium was passed.

The House Judiciary Committee approved H.R. 49 on July 16, 2003 after agreeing to an amendment to expand the definition of Internet access to include all modes of accessing the Internet (see H.Rept. 108-234). Treasury Secretary Snow expressed the Bush Administration's support for the legislation in a recent press release. H.R. 49, as amended, passed the House under suspension of the rules on September 17, 2003.

The Senate Commerce Committee held hearings on making permanent the Internet tax moratorium and eventually reported out S. 150 (see S.Rept. 108-155). After the Commerce Committee reported out S. 150, it was referred to the Senate Finance Committee for consideration for a period not to exceed 30 calendar days. S. 150 was discharged from the

Finance Committee and placed on the Senate calendar on October 29. The Senate debated S. 150 on November 6 and 7.

S. 150 would make the moratorium permanent, however, some have argued that the definition of Internet access in the legislation is so broad that telecommunications services, which are currently subject to state and local taxes, would be swept into the moratorium. The Nati onal Governor's Association contends that the broadened definition Internet access could cost the states between $4 billion and $9 billion by 2006. The CBO estimated that "Other states are currently imposing taxes on charges for the portions of DSL [digital subscriber line] services they do not consider Internet access. Those states would lose at least $40 million in the sales and use taxes on DSL services in 2004, and at least $75 million by 2008." Proponents of the permanent moratorium counter that Congress does not intend to include otherwise taxable services in the moratorium.

After negotiating with stakeholders and the House leadership, the Senate failed to approve an extension, temporary or permanent, of the Internet tax moratorium in the final days of the current Congressional session. On November 25, 2003, Senate Majority Leader Frist stated, however, that: "I will make passing a meaningful, revised Internet tax moratorium a priority for next year (2004)." For more on other internet tax legislation in the 108th, see CRS Report RL31929, *Internet Tax Bills in the 108th Congress*, by Nonna Noto.

Remote Vendor Tax Collection. The United States Supreme Court has held in 1992 (*Quill Corporation* vs. North Dakota) that a state has no jurisdiction to require a remote vendor to withhold that State's *sales* and *use* taxes unless the vendor has a nexus (loosely defined as physical presence) in the taxing state. The Court also has held that Congress, under its power to regulate interstate commerce, could authorize the states to require the collection of these taxes by remote vendors. This issue is important because Internet transactions do not have the sales and use tax levy included by remote vendors, thus Internet retailers are thought to have a competitive advantage over traditional "brick and mortar" vendors who collect the tax. Note that interstate transactions are still taxable though the collection responsibility falls upon the consumer to voluntarily remit the appropriate taxes. In reality, compliance with this requirement is quite low.

The Streamlined Sales Tax Project (SSTP). A coalition of states is currently working to establish a simplified sales and use tax system. The participating states would ask Congress for the permission to compel out of state vendors to collect sales and use taxes if the simplified system were implemented. The 34 states (and the District of Columbia) participating in the simplification project are self identified as the Streamlined Sales Tax Implementing States (SSTIS). On November 12, 2002, the SSTIS approved (31 in favor, 3 absent, and 1 abstention) the model legislation identified as the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA goes into effect if 10 states representing at least 20% of the population in states that impose a sales tax enact the model legislation and are in compliance with the rules of the SSUTA. The National Governor's Association (NG A) supports the model legislation. H.R. 3184, the "Streamlined Sales and Use Tax Act," introduced on September 25, 2003, would grant SSTIS members the authority to compel out-of-state vendors to collect sales and use taxes. Hearings on the SSTP concept were held on October 1, 2003. In the Senate, Senator Enzi introduced S. 1736, which is similar to H.R. 3184, on October 15,

2003.

Through legislation like H.R. 3184 and S. 1736, Congress would authorize the SSUTA participating states to require that all vendors collect the sales and use tax based upon the customer's home State and local tax rates and base. Proponents of the SSUTA approach assert that administrative difficulties could be overcome with technology and simplified state and local government sales and use tax systems like the SSUTA. The SSUTA includes provisions that would require participating states to: (1) establish uniform tax base definitions; (2) impose uniform sales and use tax exemptions; and (3) limit the variation in local tax rates within the state. Opponents of the SSTA suggest that simplification measures will not sufficiently ease the collection burden on out-of-state vendors.

CRS Products

CRS Report RL31929, *Internet Tax Bills in the 108th Congress.*

CRS Report RL31252(pdf), *Internet Commerce and State Sales and Use Taxes.*

CRS Report RL31177(pdf), *Extending the Internet Tax Moratorium and Related Issues.*

CRS Report RS21537, *State Sales Taxation of Internet Transactions.*

CRS Report RS21596(pdf), *EU Tax on Digitally Delivered E-Commerce.*

Additional Reading

Council on State Taxation, "Report Card on Streamlined Sales Tax Implementing States' Agreement," *State Tax Notes*, November 11, 2002, p. 407.

Charles McLure Jr., "SSTP: Out of Great Swamp, But Whither? A Plea to Rationalize the State Sales Tax," *State Tax Notes*, December 31, 2001, p. 1077.

Goolsbee, Austan, and Jonathan Zittrain, "Evaluating the Costs and Benefits of Taxing Internet Commerce." *National Tax Journal,* vol. 52, no. 3 (September 1999): 413-428.

National Tax Association Communications and Electronic Commerce Tax Project Final Report, September, 1999.

U.S. Congressional Budget Office, *Economic Issues in Taxing Internet and Mail-Order Sales*, (Washington: October 2003).

U.S. General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses are Uncertain*, GAO Report OCE-00-165 (Washington: June 2000).