

**STATEMENT SUBMITTED TO THE ADVISORY COMMISSION
ON ELECTRONIC COMMERCE BY COMMISSIONERS JOSEPH GUTTENTAG,
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The Commission was charged by Congress with the important challenge of trying to provide recommendations to Congress on the significant issues surrounding state taxation of electronic commerce. Electronic commerce and the associated explosion of the information technology sector are key sources of economic growth in the United States and around the world. As the President has stated on several occasions, it is important to establish the right rules in this area in order to promote a policy environment that is pro-growth, nondiscriminatory, and provides appropriate revenues that communities need to meet vital public purposes.

Unfortunately, the Commission was not able to rise to this challenge and did not serve as a forum to forge a principled consensus on how to address the issues. Rather than foster consensus, the Commission's process instead encouraged divisiveness -- allowing posturing to take precedence over policy. This flawed process prevented the Commission from fulfilling its Congressional charge and led to a final Report that includes only the "majority" view, which is strongly opposed by the vast majority of Republican and Democratic Governors, virtually all other state and local government officials, and large segments of the business community.

The challenge of reaching a principled consensus was made more difficult by the fact that the Commission never represented the full range of stakeholders with interests in these important issues, such as "Main Street" retailers. Inclusion of these voices on the Commission -- rather than as witnesses -- would have provided more balance. Nevertheless, reasonable compromise proposals were put forward to reach a principled consensus. Unfortunately, these were rebuffed.

Moreover, procedural machinations were employed to favor some views and suppress others. By statute, Congress set a high bar for the final Report, requiring a two-thirds supermajority of Commissioners for the inclusion of valid findings and recommendations. This requirement was designed to ensure that the Commission's recommendations reflected a real consensus between stakeholders. However, once it became clear that the two-thirds supermajority required by Congress would not be obtained, the Chairman and other Commissioners supporting the "majority" proposal simply changed the rules -- rules that had been in force since the Commission's first meeting. The Chairman's coalition voted to reduce the number of votes required to forward a report to Congress and to ensure that the "majority" proposal would be included in the report as the "result" of the Commission's work.

Furthermore, the Report drafting process was not transparent, and did not foster serious discussion of the important Commission issues. The Report does not include or summarize any of the testimony provided to the Commission. Nor does the Report include substantive proposals presented to and considered by the Commission, such as those supported by the majority of state and local officials. As a result, the Report does not serve its purpose of providing Congress with all of the information and views obtained by the Commission that will assist in this important national and international debate. In view of this fundamentally flawed process and the stark inconsistency with Congress's mandate to the Commission, we voted against approval of the content of the report.

We are disappointed that the Commission was unable to reach a principled consensus able to attract the two-thirds majority required by the Internet Tax Freedom Act for a valid recommendation to Congress. There was a significant effort to do so, and the Administration worked hard to be an honest broker and a catalyst throughout this process to try to achieve a balance between the interests of technology, the needs of state and local governments, and the continued viability of traditional retailers, both large and small.

In these discussions, the primary challenge that could not be overcome was determining what should happen while the States simplify their sales and use tax systems, specifically, whether Internet sales should be granted additional tax exemptions. This would have involved changing the “nexus” rules the Supreme Court put in place – rules that have worked very well for electronic commerce since its inception – in such a way as to further restrict state’s ability to collect sales taxes that are owed. The States were willing to make concessions regarding those rules as part of an overall compromise, but unfortunately agreement with the Chairman’s coalition could not be reached. The Administration’s view is that in the absence of an overall compromise regarding sales and use taxes, the current nexus rules should not be changed legislatively.

We will continue to participate in constructive discussion of these issues in the future with state and local officials, representatives from all sectors of the business community, members of Congress, and anyone who in good faith seeks to find solutions to these important and complex issues. We continue to support and believe that there is substantial consensus on the following substantive positions:

1. **No Internet Access Taxes**

The current statutory moratorium on Internet access taxes should be made permanent.

It is critically important to encourage access to the Internet. Because taxes on Internet access would create an obstacle to the access of all Americans to the Internet, and in turn, their ability to participate in electronic commerce, these taxes should be prohibited permanently.

2. **No Multiple and Discriminatory Taxes**

The current statutory moratorium on multiple and discriminatory taxes should be extended.

Multiple or discriminatory taxes on electronic commerce plainly would hinder its development. This existing statutory moratorium should be extended, and final protections against such taxes should be crafted after the States develop simplified sales tax systems.

3. **Simplification and Reformation of State and Local Taxes on Telecommunications**

States and local governments should work expeditiously, in conjunction with the

private sector to simplify and reform these taxes. The goal of these reforms should be neutrality in taxation of telecommunications as compared to other sectors as well as neutrality in taxation of providers of similar telecommunications services.

This complex web of taxes is in large part a relic of the time when telecommunications services were a regulated monopoly and when taxes on these services were passed on to consumers through the regulated rate structure. Today, telecommunications on all levels have moved from regulated monopoly to competitive markets, and the line between telecommunications and other types of services becomes less clear every day. State and local governments have recognized the pressing need for reform in this area. We believe that these governments, working in cooperation with businesses and consumers, can accomplish this goal.

4. Simplification of State and Local Sales and Use Taxes

States and localities should develop a simplified sales and use tax system within two years. During that time, the current rules governing this area, which were established by the Supreme Court, should remain unchanged.

While this simplified system is being developed, States and localities should engage in a dialogue with businesses and consumers to address the complex and difficult issues regarding the application of these taxes to Internet sales. These issues include:

- fairness to both Internet businesses and “bricks and mortar” businesses;**
- significantly reducing or eliminating the cost to businesses of collecting these taxes;**
- the effect of these taxes on the international competitiveness of U.S. Internet companies;**
- whether lower-income Americans are paying, or will be required to pay, an unfair and disproportionate share of state and local sales taxes;**
- ensuring protection of consumer privacy; and**
- the feasibility of imposing and collecting sales taxes on goods delivered digitally over the Internet (software, music, etc.).**

The application of sales tax laws to Internet transactions raises difficult issues. It is essential that we maintain the vitality of electronic commerce, which is one of the primary drivers of our economy. It also is essential that States and localities have the revenues they need to provide citizens with essential services – such as education, police, fire protection. Addressing this issue is extraordinarily complex for a number of reasons, including the fact that policymakers do not now have all of the information they need. Everyone agrees, however, that simplification is the key. So the States should proceed in developing a model

act that produces real and effective simplification, while discussion on the other issues continues. While the model act is being developed, which is estimated to take two years, the current sales and use tax rules, established by the Supreme Court, should remain in place; they plainly have not hindered the growth of electronic commerce. In the event of any change in existing rules governing the application of sales and use taxes to Internet sales, there should be full accountability so that citizens of each State can determine the appropriate consequences of any projected increase in revenue.

5. Review of the Continued Viability of the Federal Excise Tax on Communications

Phase out of this tax is a worthy policy objective and should be considered, but must be weighed against other worthy objectives including other proposed tax reductions, and must not be allowed to threaten the important priorities of maintaining fiscal discipline, paying down the national debt, extending the solvency of Medicare and Social Security, and maintaining core government functions such as health care and education.

This tax contributes more than \$4 billion in revenue per year and \$52 billion over ten years. Because of this substantial budgetary impact, phasing out of the tax cannot be considered in a vacuum, but must be weighed against other important priorities.

6. No Customs Duties on Electronic Transmissions

The current moratorium on customs duties on electronic transmissions should be made permanent.

Maintaining the moratorium on customs duties on electronic transmissions is a goal shared both domestically and internationally. There is a broad recognition that imposing customs duties on electronic transmissions would only undermine the ability to attract the investment and technology necessary to build and develop an e-commerce infrastructure.

7. Fair International Taxation

Any taxation of electronic commerce should be neutral, nondiscriminatory, simple, certain, fair and flexible.

Regarding international taxation of electronic commerce, our view is that any taxation of electronic commerce should be neutral and non-discriminatory. We must continue to work within the Organization for Economic Cooperation and Development (OECD) to agree on tax rules based on the principle of neutrality and other core principles, such as simplicity, certainty and fairness. We must also continue to work with non-OECD member countries. Global electronic commerce should not be impeded by globally inconsistent tax treatment and thus a global consensus must be reached regarding appropriate taxation.