

A Proposal for Internet Tax Reform and Reduction

**A 21st Century Approach Presented by the
ACEC Business Caucus**

This proposal, if adopted, would establish an environment that continues to foster innovation and technological advancement in the development of the Internet and electronic commerce while, at the same time, recognizing the role of the state and local governments to continue providing needed services to its citizenry. It is consistent with our beliefs that Governments should keep the tax and administrative burden on consumers and businesses as low as possible. It is also consistent with our view that federal policies in this area should be respectful of the sovereignty of sub-federal jurisdictions and interstate commerce. The best way to strike a balance between the national and state interests will be through earnest and open debate among all affected parties. We hope this proposal fosters that debate.

In addressing whether and how the Internet should be subject to taxation, a major priority should be reducing or removing the barriers to access to perhaps the most advanced and useful medium of communications and commerce yet devised. That imperative has infused the various access and telecommunications tax recommendations in this proposal which will, cumulatively, drive down the cost of connecting to the Internet and consequently increase the numbers of those who can afford to connect.

The advent of electronic commerce raises new challenges for traditional state and local tax systems. We do not presume that the collection of sales and use taxes on Internet transactions is an inevitability. We believe, however, that there is a need to begin a dialogue that will lead to the substantial simplification and reform of the current systems if they are to continue to remain viable in the 21st century. Now is not the time to ignore the challenge of reform, and it is not the time for incremental adjustment. Rather, now is the time to take a hard look at state and local transaction taxes, to determine whether they can be restructured in light of technological change, and then to take action. This proposal is intended to enable all consumers, whether or not they make purchases on the Internet, to enjoy the benefits of a new, restructured sales and use tax system. The hallmark of the system should be simplicity, efficiency and fairness.

Our system of federalism mandates that the burden to produce such a system falls on the states. This proposal gives the states five years to simplify their state and local transaction tax systems in a manner which would equalize the burdens of tax collection for local and remote sellers. In other words, we believe the system should not be more burdensome on a business that collects and remits taxes to several taxing jurisdictions than it is to a business that collects and remits taxes in a single taxing jurisdiction. By eliminating any disparate burden on interstate commerce, states will have a pathway toward a system that extends their collection of existing state taxes to remote sellers. In the interim, we suggest several clarifications to remote sales tax collection that should

benefit both state and local governments and vendors by drawing some "bright lines" for guidance, thereby reducing costly litigation and uncertainty. To enable fair and equal treatment of retailers and e-tailers, as well as consumers who don't have internet access, we also suggest that the sale of certain products available in both digital and tangible forms be exempt from sales tax during the moratorium period.

Because we do not believe that any party in the debate has sought to increase tax revenues through more taxes, we believe it is appropriate for states whose overall sales and use tax revenue collections increase as a result of use tax collections on remote sales to make a substantial and proportional reduction in their overall sales tax rates, thus maintaining revenue neutrality in overall sales and use tax collections.

The proposal will achieve these goals through the following five-part approach:

1/ Substantially reducing the overall burden on consumers due to state and local sales taxes by radically simplifying state and local tax systems, and reducing the aggregate collection costs of all transactions, which will allow all sellers to pass on those cost savings to taxpayers;

2/ Creating a simple and equitable system for state and local sales taxes that would impose equal obligations and costs on all sellers, local or remote, regardless of sales channel or technology utilized;

3/ Addressing concerns regarding the digital divide and the regressive character of state and local transaction taxes by eliminating the disparate tax treatment of main street and Internet sales, banning taxes on Internet access and reducing overall transaction tax rates;

4/ Eliminating the federal excise tax on telecommunications, simplifying state and local telecommunications taxes and eliminating multiple and discriminatory taxation of telecommunications services and property; and

5/ Protecting the privacy of consumers by minimizing the disclosure of personal information for tax collection purposes.

The proposal recommends that Congress enact legislation that:

(1)(a) for a period of five years, extends the current moratorium barring multiple and discriminatory taxation of electronic commerce and prohibits taxation of sales of digitized goods and products and their non-digitized counterparts.

(1)(b) makes permanent the current moratorium on any transaction taxes on the sale of Internet access, including taxes that were grandfathered under the Internet Tax Freedom Act.

(2) clarifies that the following factors would not, in and of themselves, establish a seller's physical presence in a state for purposes of determining whether a seller has sufficient nexus with that state to impose collection obligations: (a) a seller's use of an Internet service provider that has physical presence in a state; (b) the placement of a seller's digital data on a server located in that particular state; (c) a seller's use of telecommunications services provided by a telecommunications provider that has

physical presence in that state; (d) a seller's ownership of intangible property that is used or is present in that state, (e) the presence of a seller's customers in a state (f) a seller's affiliation with another taxpayer that has physical presence in that state; (g) the performance of repair or warranty services with respect to property sold by a seller that does not otherwise have physical presence in that state; (h) a contractual relationship between a seller and another party located within that state that permits goods or products purchased through the seller's website or catalogue to be returned to the other party's physical location within that state; and (i) the advertisement of a seller's business location, telephone number and website address.

(3) clarifies that, in determining whether a seller has sufficient nexus with a state to be required to meet business activity and income tax reporting and payment obligations of that state, the following factors would not be taken into account:(a) all of the factors listed in (2)(a) through (i) above, and (b) a seller's sales and use tax registration with that state and/or a seller's collection and remittance of use taxes for that state.

(4) encourages state and local governments to work with and through the National Conference of Commissioners on Uniform State Laws (NCCUSL) in drafting a Uniform Sales and Use Tax Act within three years after the expiration of the current ITFA moratorium (i.e., October 21, 2004) that would simplify state and local sales and use taxation policies so as to create and maintain parity of collection costs (net of vendor discounts) between remote sellers and comparable single-jurisdiction vendors that do not offer remote sales, including providing the following:

- (a) uniform tax base definitions
- (b) uniform vendor discount
- (c) uniform and simple sourcing rules
- (d) one sales and use tax rate per state and uniform limitations on state rate changes
- (e) uniform audit procedures
- (f) uniform tax returns/forms
- (g) uniform electronic filing and remittance methods
- (h) uniform exemption administration rules (including a database of all exempt entities to determine exemption status)
- (i) a methodology for approving software that sellers may rely on to determine state sales tax rates
- (j) a methodology for maintaining revenue neutrality in overall sales and use tax collections within each state (such as reducing the state-wide sales tax rate) to account for any increased revenues collected (on a voluntary basis or otherwise) from remote sales.

(5)(a) establishes a new Advisory Commission responsible for oversight of the progress of NCCUSL's efforts to create a Uniform Sales and Use Tax Act.

(5)(b) within six (6) months after the completion of NCCUSL's work, the Commission shall transmit to Congress for its consideration a report containing the following:

(1) findings, for the period from 1999 through 2004, regarding the growth of electronic commerce, the impact of electronic commerce on traditional retailers, and the impact of remote sales on state tax revenues,

(2) an assessment of whether the Uniform Sales and Use Tax Act meets the standards listed in (4)(a) through (j) above;

(3) an assessment of whether the adoption of the Uniform Sales and Use Tax Act would result in equal tax collection burdens (net of vendor discounts) for remote sellers and comparable single-jurisdiction vendors that do not offer remote sales;

(4) an assessment of whether requiring all remote sellers to collect and remit sales and use taxes to those states that adopt the Uniform Sales and Use Tax Act would impose any unreasonable burden on interstate commerce or would otherwise adversely impact economic growth and activity through remote electronic channels;

(5) a recommendation as to whether states that adopt the Uniform Sales and Use Tax Act should be permitted to collect sales and use taxes on all remote sales; and

(6) any other recommendations as required to address the findings of the Commission's report.

(6) encourages state and local governments to work with and through the National Conference of Commissioners on Uniform State Laws (NCCUSL) in drafting a Uniform Telecommunications State and Local Excise Tax Act, within three (3) years, that would require states to follow one of two simplified tax structure models, either Model A which would:

- (a) allow only one state transaction tax
- (b) require each telecommunications provider to file only one tax return per reporting period per state
- (c) allow only one audit at the state level
- (d) establish nationwide uniform sourcing methods
- (e) establish nationwide uniform definitions
- (f) provide for 120 days lead time for implementing tax base and rate changes

or Model B, which would contain all the provisions of Model A but would allow one local level option tax in states where localities are currently authorized to impose tax, with the following requirements:

- (a) tax base and exemptions conform to the state tax
- (b) single tax return filed with the state return and with state distribution of funds
- (c) unified audit conducted at the state level
- (d) state-administered address, jurisdiction and rate database in a nationwide uniform format that would assign addresses to appropriate taxing jurisdiction and provide the rate

- (e) telecommunication providers would be held harmless if they rely on the database
- (f) provide a vendors' compensation

(7) eliminates the 3% federal excise tax on communications services

(8) encourages state and local governments to eliminate the excess tax burden on telecommunications by: (a) eliminating telecommunications industry-specific and higher transaction tax rates; (b) eliminating the excess tax burdens on telecommunication real, tangible and intangible property; and (c) affording similar treatment of telecommunications infrastructure in states that exempt purchases of certain types of business equipment from the sales and use taxes.

(9) establishes a process (or timeline) for states to adopt the Uniform Telecommunications State and Local Excise Tax Act and to remove excess and multiple taxation of telecommunications. States that fail to adopt the Act and to remove the excess and multiple taxation within 3 years after the expiration of the current ITFA moratorium would be subject to Federal requirements against adverse discrimination in taxation of telecommunications services, property or providers in relation to other services, property and providers within a state.