



ADVISORY COMMISSION ON  
ELECTRONIC COMMERCE

# REPORT TO CONGRESS

APRIL 2000

## *Letter of Transmittal*

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## *Executive Summary*

The Advisory Commission on Electronic Commerce met in four in-person meetings: Williamsburg, Virginia; New York City, New York; San Francisco, California; and Dallas, Texas. At its final meeting in Dallas on March 20 and 21, 2000, the Commission voted on a number of proposals bearing on the subject of the Commission's charter. Certain of those proposals received a 2/3rds vote and, pursuant to the statute, represent findings and recommendations of the Commission. Other proposals, including those pertaining to state sales and use taxes, received a majority vote of the Commissioners and are identified as such throughout the report. Under the terms of the statute, those proposals do not constitute formal findings or recommendations of the Commission.

The domestic tax proposals, if implemented by Congress, would establish an environment that continues to foster innovation and technological advancement in the development of the Internet and electronic commerce ("e-commerce") while, at the same time, recognizing the role of state and local governments to continue providing needed services to their citizens. The proposals, adopted by a majority of the Commissioners, are consistent with the belief that governments should keep the tax and administrative burden on

consumers and businesses as low as possible. They are also consistent with the view that federal policies in this area should respect 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.



In addressing whether and how the Internet should be subject to taxation, a major priority should be reducing or removing 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 discussions in this proposal, which

## Executive Summary

*The advent of e-commerce raises new challenges for traditional state and local tax systems. It should not be presumed that the collection of sales and use taxes on Internet transactions is an inevitability.*



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 e-commerce raises new challenges for traditional state and local tax systems. It should not be presumed that the collection of sales and use taxes on Internet transactions is an inevitability. There is, however, a need to begin a dialogue that will lead to the substantial simplification and reform of the current tax systems if they are to continue to remain viable in the 21<sup>st</sup> 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. These proposals are 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 of producing such a system falls on the states. The proposals adopted by a majority of the Commissioners suggest giving 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. 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, there should be several clarifications to

remote sales tax collection duties that would benefit both state and local governments and vendors by drawing some “bright lines” for guidance. These guidelines would provide clarity, thereby reducing costly litigation and uncertainty and enabling equitable treatment of retailers and “e-tailers,” as well as consumers who do not have Internet access. In addition, the sale of certain products available in both digital and tangible forms should be exempt from sales tax during the moratorium period.

No party in the debate has sought to increase tax revenues through more taxes. Therefore, 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 communications services, 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.

E-commerce raises new tax compliance and administrative issues for national income tax and consumption tax systems. An international perspective is necessary to address this subject since e-commerce potentially crosses national borders to a greater extent than other, traditional forms of doing business. Therefore, it is important for every nation to give serious consideration to the impact on its trading partners of any new or amended rules for taxation of e-commerce. In order to minimize the potential for double taxation, an international consensus for the taxation of e-commerce should be developed. The Organisation for Economic Co-operation and Development ("OECD") is the appropriate forum to sponsor the required international dialogue, which will require input from the business community and non-OECD countries.

The Advisory Commission on Electronic Commerce believes the Congress of the United States can facilitate the international dialogue by adopting the proposal described herein. The proposal receiving a majority vote of

the Commissioners is based on the conclusion that existing, internationally accepted tax rules should be applied to e-commerce. No new taxes are required. In addition, the goals of simplification, neutrality, greater certainty, and avoidance of double taxation are equally significant.

The Advisory Commission on Electronic Commerce was established pursuant to P.L. 105-277, Div C, Title XI Stat. 2681-719, and codified as 47 U.S.C.S. § 151 Sec. 1102 (H.R. 4328) (referred to herein as the "Internet Tax Freedom Act" or the "Act"). As set forth in the Act, the Commission's statutory mandate is to study "federal, state and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities."<sup>1</sup> The Act requires the Commission to complete its study within 18 months and transmit its findings, including any legislative recommendations, to Congress.

The Act directed Senate and House leadership to appoint 19 commissioners including: the Secretary of Commerce, the Secretary of the Treasury and the United States Trade Representative (or their respective delegates), eight representatives from state and local governments (including one from a state or local government that does not impose a sales tax, and one representative from a state that does not impose an income tax), and eight representatives from the e-commerce industry (including small businesses), telecommunications carriers, local retail business and consumer groups.<sup>2</sup>

## Executive Summary



<sup>1</sup> *Internet Tax Freedom Act*, 47 U.S.C. § 151, sec. 1102(g)(1998).

<sup>2</sup> *Internet Tax Freedom Act*, 47 U.S.C. § 151, sec. 1102(a)(1998).

## Executive Summary



## Formal Findings and Recommendations

### 1. Digital Divide

*The following items received more than 2/3rds (15) of the Commissioners' support and are considered recommendations:*

- Clarify federal welfare guidelines expressly to permit the states to spend Temporary Assistance to Needy Families Program (TANF) surpluses (unobligated balances) to provide needy families access to computers and the Internet, and to provide training in computers and Internet use.
- Encourage states and localities to partner with private technology companies to make computers and the Internet widely accessible for needy families, libraries, schools, and community centers and to train needy families how to use computers and the Internet. Incentives for these partnerships may include:
  - federal and state tax credits and incentives for private technology companies that partner with state and local governments; and
  - federal matching funds for state and local expenditures.
- Encourage the Administration and Congress to continue gathering data for empirical research that will inform federal, state and local policymakers on measures that will lead to the reduction, and eventual elimination, of the Digital Divide by

empowering families in rural America and inner cities to participate in the Internet economy.

### 2. Privacy Implications of Internet Taxation

*The following items received more than 2/3rds (16) of the Commissioners' support and are considered recommendations:*

- Explore the privacy issues involved in the collection and administration of taxes on e-commerce, with special attention given to the costs that any new system of revenue collection may have upon other values that U.S. citizens hold dear, and the steps taken in systems developed to administer taxes on e-commerce to safeguard and secure personal information.
- Take great care in the crafting of any laws pertaining to online privacy (if any such laws are necessary), because policy missteps could endanger U.S. leadership in worldwide e-commerce.

### 3. International Taxes and Tariffs

*The following item received more than 2/3rds (18) of the Commissioners' support and is considered a recommendation:*

- Support implementing and making permanent a standstill on tariffs at the earliest possible date.

## Majority Policy Proposals

### 1. Sales and Use Taxes

*The following items received a majority (11) of the Commissioners' support:*

- For a period of five years, extend the current moratorium barring multiple and discriminatory taxation of e-commerce and prohibit taxation of sales of digitized goods and products and their non-digitized counterparts.
- Clarify which 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.
- Encourage 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 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.
- Establish a new advisory commission responsible for oversight of the progress of NCCUSL's efforts to create a uniform sales and use tax act.

### 2. Business Activity Taxes

*The following item received a majority (11) of the Commissioners' support:*

- Clarify the circumstances that determine 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.

### 3. Internet Access

*The following item received a majority (11) of the Commissioners' support:*

- Make 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.

### 4. Taxation of Telecommunications Services and Providers

*The following items received a majority (11) of the Commissioners' support:*

- Eliminate the 3% federal excise tax on communications services.
- Eliminate excess tax burdens on telecommunications real, tangible and intangible property.
- Afford similar treatment of telecommunications infrastructure in states that exempt purchases of certain types of business equipment from sales and use taxes.
- Encourage state and local governments to work with and through NCCUSL in drafting a uniform telecommunications state and local excise tax act, within three years, that would require states to follow one of two simplified tax structure models.

### 5. International Taxes and Tariffs

#### A. Tariffs

*The following item received a majority (11) of the Commissioners' support:*

- Support the formal, permanent extension of the World Trade Organization's current moratorium on tariffs and duties for electronic transmissions.



## Executive Summary



### **B. International Taxes on Goods and Services**

*The following items received a majority (11) of the Commissioners' support:*

- Recognize the OECD's leadership role in coordinating international dialogue concerning the taxation of e-commerce; affirm support for the principles of the OECD's framework conditions for taxation of e-commerce; and support the OECD's continued role as the appropriate forum for (1) fostering effective international dialogues concerning these issues; and (2) building international consensus.

- Encourage and support (including adequately funding) the U.S. Government's efforts to further international dialogue concerning the

taxation of e-commerce, which are consistent with the principles outlined above.

- Refrain from adopting legislative proposals affecting international transactions or activities that are inconsistent with the principles enumerated above.

### **6. The Need for Improved Knowledge of International Ramifications**

*The following item received a majority (11) of the Commissioners' support:*

- Congress should increase its oversight of the international ramifications of domestic Internet commerce decisions.

The Commissioners closed their final, formal meeting with expressions of optimism that the process they began will result in a continued, national dialog about the impact of e-commerce on the nation and its states and its people. The Commission believes that its discussions have furthered public education and will provide an enduring legacy as Congress and the people continue to debate this

most important series of issues. The Commissioners acknowledged that in the end, there was little disagreement among themselves. All of the Commissioners were pleased to have had the opportunity to serve in this capacity and believe that their efforts have elevated the examination of broader taxing issues on today's and tomorrow's agendas.

## A. *The Evolution of Electronic Commerce*

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The Internet is a vast multinational framework comprised of more than 150,000 individual networks and used by more than 304 million people around the globe.<sup>3</sup> The Internet's commercial as well as individual consumer use has skyrocketed since 1995. During these last five years, the Internet has spurred the development of new businesses, products and services, enabled unprecedented innovation as well as new and less expensive methods for research and communication. For individuals, the Internet provides access to a virtually limitless amount of unfiltered information, consumer choices, and communication.

Five years ago, the terms "electronic commerce" and "e-commerce" were virtually unheard of; today, they are household words. Notwithstanding the common usage of these terms today, the meaning and breadth of these terms are still very much uncertain. For example, it could be argued that e-commerce refers only to transactions conducted over the

Internet. Conversely, e-commerce could include all transactions using the same telecommunications infrastructure as the Internet such as catalogue orders placed by telephone or facsimile.

For purposes of this report, "e-commerce," as defined in the Internet Tax Freedom Act, includes "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access."<sup>4</sup> The Act also specifically requires all recommendations to be "tax and technologically neutral and [to] apply to all forms of remote commerce."<sup>5</sup> Therefore, the Commission's recommendations on taxation are intended to apply to all forms of remote commerce regardless of whether conducted over the Internet, through the telephone, via facsimile, through the common carrier or by any other means.

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<sup>3</sup> Nua, Ltd., "Internet Surveys," (visited Mar. 3, 2000) <[http://www.nua.ie/surveys/how\\_many\\_online/index.html](http://www.nua.ie/surveys/how_many_online/index.html)>.

<sup>4</sup> 47 U.S.C. § 151 sec. 1004(3)(1998).

<sup>5</sup> *Id.*



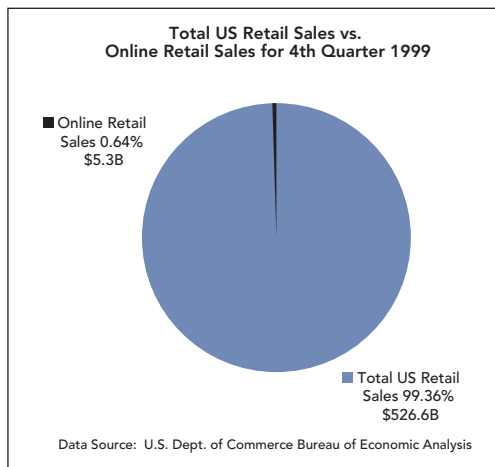


## B. *The Impact of Electronic Commerce on the Economy*

No matter how e-commerce is defined, its substantial growth, along with the growth of the Information Technology (“IT”) producing sector, is propelling U.S. economic expansion. The IT producing sector consists of companies that develop the advanced hardware and software and provide the services that have not only made the Internet an extraordinarily fertile environment for innovations creating new value and greater efficiency, but also other non-Internet, information and communication-based innovations that have supported a record of rapid and sustained economic growth.

Many private-sector research firms and academic institutions are conducting studies on the rapid rise of e-commerce and its positive ripple effects throughout the economy. Existing growth estimates vary greatly, however, due to the varying definitions and research methodologies these firms use to collect and analyze data. For example, some studies have focused on business-to-business transactions to gauge growth and economic impact while others have focused on business-to-consumer

transactions. Variations among reports also turn on distinctions between the discreet business sectors that constitute



e-commerce, ranging from hardware and software to electronic retailing and backbone infrastructure and telecommunications.

On March 2, 2000, the United States Department of Commerce (“Commerce Department”) Census Bureau released its first official estimate of online retail sales. According to this estimate, online retail sales equaled \$5.3 billion or 0.64% of total retail sales during the

<sup>6</sup> U.S. Department of Commerce, Press Release, “Retail E-Commerce Sales for The Fourth Quarter 1999 Reach \$5.3 Billion,” Census Bureau Reports (rel. Mar. 2, 2000).

## Background

### *The Impact of Electronic Commerce on the Economy*

fourth quarter of 1999.<sup>6</sup> For purposes of this estimate, the term “retail sales” includes only sales of tangible goods (e.g., books, computer equipment, furniture and apparel) and does not include sales of services (e.g., entertainment, travel or financial services). This new e-commerce indicator will be released on a quarterly basis.

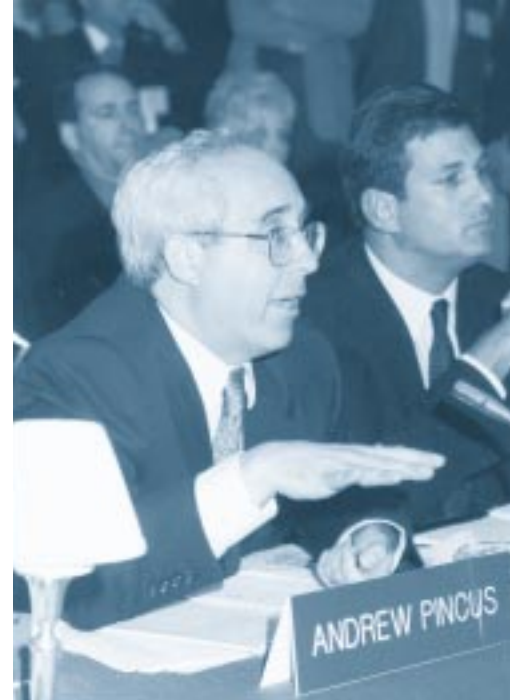
The Commerce Department’s estimate indicates that along with the rise in online retail sales, the IT sector as a whole (which includes the Internet) is fueling the continued growth of the overall economy. The Commerce Department also estimates that production by the IT sector accounts for only 8% of the Gross Domestic Product (“GDP”).<sup>7</sup> However, its rapid 18.8% real growth rate from 1994 to 1998 (the four most recent years estimated) accounted for 35% of the nation’s real economic growth.<sup>8</sup> By comparison, the average growth of the overall economy during that same period was approximately 4%.<sup>9</sup>

Furthermore, the Internet and other online sales<sup>10</sup> may have important implications for other sectors of the economy, by driving efficiencies and increasing productivity, therefore bolstering GDP. To measure the online business activity in these other sectors, the Commerce Department is gathering data on 1998 and 1999 business activity occurring online for the sectors of retailing, wholesaling, manufacturing, food and accommodations, and service industries.

In 2001, the Commerce Department will release improved GDP accounts and other data including benchmark e-

commerce data. This data will provide the first official separate analysis of e-business-related activity.

Just as the domestic economy is being influenced by the Internet and the



IT sector, international trade and finance are also being transformed by these technologies, and therefore, are becoming more difficult to measure. In 2001, the Commerce Department will release improved measures of international trade in goods and services and international financial and capital transactions.

The Commerce Department’s introduction of improved measurements of the growth of e-commerce and the IT sector will bring consistency to future analyses of this industry’s growth. The data collected and studies conducted to date, however, are still useful in

<sup>7</sup> U.S. Department of Commerce, *Emerging Digital Economy II*, at 16 (June 1999).

<sup>8</sup> *Id.* at 19.

<sup>9</sup> U.S. Department of Commerce, Bureau of Economic Analysis (March 2000) <<http://www.bea.doc.gov/bea/newsrel/gdp499>>.

<sup>10</sup> Online sales include Internet, electronic data interchange, extranets and other online services.

identifying new and evolving trends resulting from the growth of the Internet and e-commerce. For example, the Internet is causing an evolution of business models. Early commercial ventures onto the Internet were generally limited to business models with “virtual” storefronts. These businesses operate only on the Internet and do not have physical storefronts (although they do have physical locations to facilitate back-end billing and fulfillment).

Today, traditional, physical retailers also are incorporating e-commerce tools into their business models and using the Internet to create Web sites as additional distribution channels through which to sell their goods and services. These retailers, often referred to as “click and mortar”<sup>11</sup> businesses, benefit from having a Web presence because many

consumers still rely on the tangible experience they have gained inside a brick and mortar store when making an online purchase. There is also significant business-to-business use of the Internet to realize efficiencies in distribution, order fulfillment, billing, and other operational areas. Traditional catalogue-only sellers are also joining the ranks of virtual retailers and creating Web sites.

The trends in consumer buying behavior are more difficult to identify than emerging business models. With Internet commerce only in its fifth full year, it is still early to draw conclusions and make projections on the extent to which consumers of Internet goods and services are shifting their purchases from other retail channels, such as catalogues, or simply increasing their overall purchases.

## Background

### *The Impact of Electronic Commerce on the Economy*

*... it is still early to draw conclusions and make projections on the extent to which consumers of Internet goods and services are shifting their purchases from other retail channels.*

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<sup>11</sup> The term “click and mortar” stems from the term “brick and mortar” and refers to those businesses that conduct business through both a physical storefront and a Web site. “Brick and mortar” businesses, also known as “Main Street retailers,” are businesses that only conduct business through physical storefronts.



## C. *The Impact of Electronic Commerce on State/Local Government Revenues*

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Some have expressed a concern that the rise in businesses conducting remote commerce, combined with a shift in consumer buying habits, will lead to a decrease in state and local sales and use tax revenues. In order to determine the immediacy of these concerns, it is necessary to examine how the rise of Internet sales has thus far altered sales tax collections. It is also important to examine all available evidence regarding the predicted future collection of these taxes.

In order to understand these trends and predictions, however, it is essential to understand how and why the use tax corollary to the sales tax operates. Currently, 45 states impose a state sales tax. All states that levy sales taxes also levy use taxes. Use taxes are most commonly due when an item is purchased from a business in another state and the business does not have sufficient presence (nexus) in the consumer's state for the sale to be subjected to sales tax. In the event that a consumer purchases an item and the

sales tax is not collected, the consumer is required to remit the use tax according to the location of consumption of the item. However, the rate of remittance of the use tax is low for business-to-consumer sales. One reason for these low collection rates is that taxing agencies have no practical means of identifying individual purchases or their consumers, making enforcement difficult and in many cases not cost effective. Most use tax remittances come from business-to-business sales where businesses are registered within the states and subject to audits. There is no conclusive data to indicate what the collection rates of the use tax would be on business-to-consumer sales if jurisdictions increased enforcement and public education of use tax obligations.

Most Internet commerce involves business-to-business sales. Forrester Research, Inc. estimates that business-to-business Internet commerce will grow from \$43 billion in 1998, to \$1.3 trillion by 2003, accounting for 9.4% of all business-to-business sales.<sup>12</sup> Business-



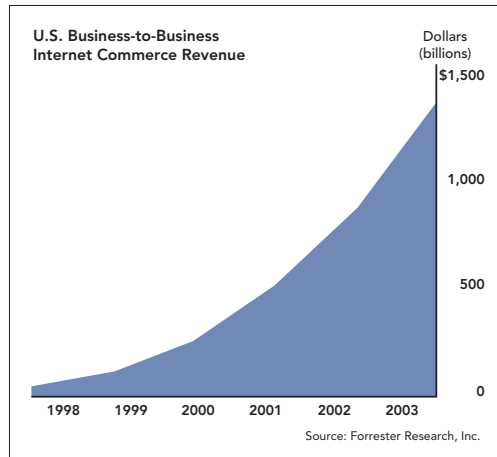
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<sup>12</sup> Steven Bell, et. al., Forrester Research, Inc., "Resizing On-Line Business Trade," (Nov. 1, 1998) at 2; and Seema Williams, et. al., Forrester Research, Inc., "Post-Web Retail," (Sept. 1999).

## Background

### *The Impact of Electronic Commerce on State/Local Government Revenues*

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to-business Internet sales pose fewer issues regarding sales or use tax collection due to higher compliance rates resulting from audits by taxing authorities. The actual amount of use tax assessed varies from state to state depending on how extensive of an audit program a state maintains.

It is especially difficult to calculate the amount of sales and use tax not collected on business-to-consumer Internet sales or on any other remote sales. Some academic estimates suggest that uncollected taxes resulting from Internet sales will be less than 2% of all sales tax revenue in 2003.<sup>13</sup>

Many of these estimates do not distinguish between sales of taxable and non-taxable goods and services. Further, it should be noted that, to the extent Internet sales are displacing what would have otherwise been non-Internet remote sales to consumers, the use of the Internet to facilitate a sale does not increase the tax loss to state and local governments. To the extent Internet sales are replacing purchases that would have otherwise been made through a “brick and mortar” store that collected sales tax, revenue losses to states and local governments could occur. However,

even this is complicated by the fact that some remote sellers collect sales and use taxes voluntarily, while other “click and mortar” sellers are required to collect sales taxes based on their substantial nexus in a state where their product is delivered. There is no data on how many businesses are collecting taxes on remote business-to-consumer sales.

Adding to the complexity of determining the amount of sales taxes actually collected on business-to-consumer sales, some “click and mortar” retailers are not collecting sales and use taxes on items purchased through the Internet where substantial nexus may be an issue. Certain businesses that have a large physical presence throughout the country have established their Web operations as separate entities which have a much more limited physical presence. Although their Web addresses carry the name of the parent company and they advertise their Internet sites in their stores, their Web sites are separate from their “Main Street” retail operations. Accordingly, most are only collecting and remitting sales taxes in the states where the “dot com” affiliate has substantial nexus.

It is, however, still early to predict what the trends are and how these trends will affect state and local government revenues. Presently, government revenues appear to be reaching, or in some cases exceeding, state government predictions for annual budgets. According to a National Conference of State Legislatures’ (NCSL) analysis of 1999 revenues, at the beginning of 2000, states are “generally in good to excellent fiscal condition.” Furthermore, the NCSL report stated that 20 states will exceed initial revenue expectations, and 29 states and the

<sup>13</sup> Austan Goolsbee and Jonathan Zittrain, “Evaluating the Costs and Benefits of Taxing Internet Commerce,” *National Tax Journal*, vol. 52 no. 3 (Sep., 1999); and Donald Bruce and William F. Fox, “E-Commerce in the Context of Declining State Sales Tax Bases,” (Feb. 2000).

District of Columbia anticipate that revenue collections will be on target with estimates.<sup>14</sup> Only Louisiana downgraded its original estimate of revenue collections for FY 2000. As for their ability to provide services, NCSL stated that almost all states' spending will match original budgets and states will have sufficient revenues to meet additional spending needs.<sup>15</sup>

NCSL's reports are confirmed by reports published jointly by the National Governors' Association and the National Association of State Budget Officers. According to the fiscal survey of states for 1998 and 1999, the 50 states, in the aggregate, collected \$11.3 billion in revenue surpluses for 1998 and \$7.5 billion in 1999. Surpluses for state sales taxes totaled \$2.3 billion in 1998 and \$2.2 billion in 1999.<sup>16</sup>

Thus, state government revenues are meeting or in some cases exceeding expectations despite the potential for untaxed sales of e-commerce. The NCSL's report of the states' good fiscal health, however, does not necessarily mean that e-commerce's growth is

having no impact on the level of untaxed sales. Flourishing state government revenues can be attributed to the existing state of the economy. According to the latest Bureau of Economic Analysis, in 1999, the real GDP in the United States grew 4.1% and real disposable personal income kept pace, growing at 4.0%. Not only do people have more income, but they are also purchasing more. Real personal consumption expenditures increased at a 5.3% annual rate during the same period.<sup>17</sup>

It is difficult to speculate how these economic conditions are contributing to the healthy status of government revenues. Perhaps, governments are collecting more revenues due to the increase in the amount of income that is taxed, or from an overall increase in purchases, or because the strong economy is leading to an increase in taxable property investments. By all accounts, however, technology-based businesses and e-commerce are contributing to the overall growth of the economy.

## Background

### *The Impact of Electronic Commerce on State/Local Government Revenues*

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<sup>14</sup> National Conference of State Legislatures, Fiscal Affairs, "State Fiscal Outlook for 2000," (Jan 5, 2000) <<http://www.ncsl.org/programs/fiscal/sfo2000.htm>>.

<sup>15</sup> *Id.*

<sup>16</sup> National Governors' Association, "Fiscal Survey of States," (Dec. 1999) <<http://www.nasbro.org/side.htm>>.

<sup>17</sup> U.S. Department of Commerce, Bureau of Economic Analysis, "Survey of Current Business National Data," (Mar. 2000).





## Section II

### Domestic Tax Issues & Proposals

## A. Sales and Use Taxes

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One of the most fundamental issues before the Commission concerns the application of state and local sales and use taxes to Internet and other remote retail sales. Sales taxes are “consumption-type”<sup>18</sup> taxes designed to generate revenue. In general, these taxes are calculated and collected by businesses at the point of sale and remitted to the appropriate taxing authorities.

Sales taxes have been levied throughout history, and became more widely applied in the United States beginning with the Great Depression. States’ authority to levy these taxes is derived from the 10<sup>th</sup> Amendment of the United States Constitution (“the Constitution”), which states, “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” Today, there are over 7,500 state and local governments levying

sales taxes out of a potential 30,000 jurisdictions.<sup>19</sup> The five states that do not levy a state sales tax are Delaware, New Hampshire, Montana, Oregon, and Alaska.<sup>20</sup> Local sales taxes are currently authorized in 33 states.

Ordinarily imposed on the sale of tangible goods, the rates for these taxes range from 0.875% to 11%.<sup>21</sup> A small number of state and local governments also impose sales tax on some services.<sup>22</sup> These include, for example, personal and repair services. Besides determining their own rates, states and, in some cases, local governments define and classify items and exempt certain items within their tax codes. Many of these exemptions target necessities, such as food and prescription medicines. Throughout the year, tax rates, definitions, classifications, and exemptions included in the sales tax code may be changed.

State and local governments that levy sales taxes rely on them as a major

*One of the most fundamental issues before the Commission concerns the application of state and local sales and use taxes to Internet and other remote retail sales.*

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<sup>18</sup> Richard D. Pomp and Oliver Oldman, *State and Local Taxation* vol. II, at 6-1 (3d ed. 2000).

<sup>19</sup> William Lilley III and Laurence J. DeFranco, iMap.com, Inc. (formerly InContext), “State County and City Sales Taxes,” at 3 (1999).

<sup>20</sup> Alaska does not levy a statewide sales tax, however local jurisdictions within the state do collect these taxes.

<sup>21</sup> See Lilley, *supra* note 19, at 3.

<sup>22</sup> Hawaii, New Mexico and South Dakota tax services, Arkansas, Connecticut, Minnesota, Ohio, and Texas have recently expanded their taxation of selected services. Pomp, *supra* note 18, Vol. II, at 6-18, 6-19.

## Domestic Tax Issues & Proposals

### Sales and Use Taxes

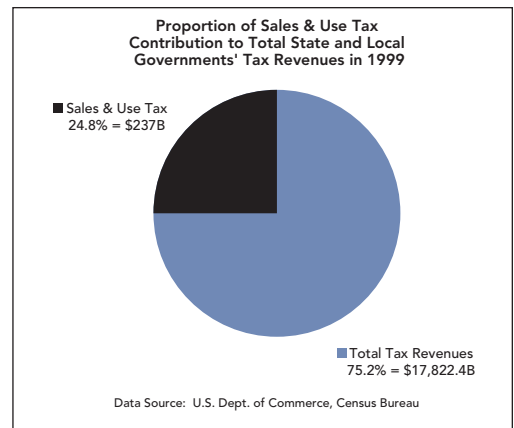
source of revenue for their general funds. According to the United States Census Bureau, state and local governments collected approximately a total of \$237 billion in sales and use taxes in 1999, comprising 24.8% of all revenues generated in that year.<sup>23</sup> Through these general funds, state and local governments provide a variety of public services to their residents.

The inability of state and local governments to require remote sellers to



collect use taxes can be traced back to a line of the United States Supreme Court (“the Court”) cases that established the “substantial nexus” standard.<sup>24</sup> These cases point to the Commerce Clause of the Constitution and Congress’ role to regulate interstate commerce as the

basis for restricting states from forcing out-of-state sellers to collect use tax.<sup>25</sup> With the explosion of e-commerce, there are concerns that an increasing number of consumers will purchase items through remote sales channels such as the Internet and catalogues, and sales tax revenues from face-to-face sales may diminish. At the same time, there are



indications that online activity is also driving increased sales for “brick and mortar” retailers.<sup>26</sup>

While the growth of e-commerce has had a positive effect on state and local government revenues, the potential impact of e-commerce on future sales tax revenues is uncertain at this time. A recent study by Forrester Research, Inc., estimates that, in 1999, state and local governments collected \$140 million in sales and use taxes from business-to-consumer purchases over the Internet, but were unable to collect approximately \$525 million in sales and use taxes from Internet retail purchases.<sup>27</sup> Two studies project future revenue losses for 2003 resulting from Internet business-to-consumer sales to be approximately \$3.5 billion, which is less than 2% of all revenue from sales and use tax collection estimated for 2003.<sup>28</sup>

While the exact impact of

*While the exact impact of e-commerce on sales tax revenues may be uncertain, clearly the need for substantial sales tax simplification is necessary in this emerging digital economy.*

<sup>23</sup> U.S. Department of Commerce, Bureau of the Census, Government and Finance Branch, *Quarterly Summary of State and Local Tax Revenue* (Dec. 14, 1999).

<sup>24</sup> *Quill Corp. v. North Dakota* By and Through Heitkamp, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Dept. of Revenue of State of Illinois*, 386 U.S. 753 (1967).

<sup>25</sup> Under the Articles of the Confederation, states levied taxes as competitive trade barriers. Resulting from the competition was a lack of uniformity that hindered interstate and international trade. To rectify this situation, the Framers of the Constitution provided Congress the authority to regulate interstate commerce. Under U.S. Const. Art. I § 8, cl. 3, Congress has the authority to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” *Pomp, supra* note 18, vol. I, at 1-1.

<sup>26</sup> Seema Williams, et al., *Forester Research, Inc., “Synchronize Channels Or Bust,”* (Apr. 1999).

<sup>27</sup> James L. McQuivey and Gillian DeMoulin *Forrester Research, Inc., “States Lose Half a Billion in Taxes to Web Retail,”* (Feb. 24, 2000).

<sup>28</sup> *Goolsbee, supra* note 13.

e-commerce on sales tax revenues may be uncertain, clearly the need for substantial sales tax simplification is necessary in this emerging digital economy. In the course of the Commission's examination of the impact of e-commerce on sales and use tax collections, there was general agreement among the Commissioners that the current sales and use tax system is complex and burdensome. Most, if not all, of the Commissioners expressed the view that fundamental uniformity and simplification of the existing system are

essential. The need for nationwide consistency and certainty for sellers as well as the need to alleviate the financial and logistical tax collection burdens and liability of sellers were common themes throughout discussions.

Commissioners also identified issues raised by sales of digitized goods over the Internet. They discussed the challenge of determining the identity and location of the consumer of digitized goods and the need to protect consumer privacy rights.

## Domestic Tax Issues & Proposals

### *Sales and Use Taxes*

### ***Majority Proposal: Sales and Use Taxes***

1. For a period of five years, extend the current moratorium barring multiple and discriminatory taxation of e-commerce and prohibit taxation of sales of digitized goods and products and their non-digitized counterparts;

2. Clarify 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 ("ISP") 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 Web site 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 Web site address.

3. Encourage state and local governments to work with and through NCCUSL in drafting a uniform sales and use tax act within three years after the expiration of the current Internet Tax Freedom Act moratorium (i.e., by 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;



## Domestic Tax Issues & Proposals

### Sales and Use Taxes



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- (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.
- 4(a) Establish a new advisory commission responsible for oversight of the progress of NCCUSL's efforts to create a uniform sales and use tax act.
- (b) Within six 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 e-commerce, the impact of e-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 (3)(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.

**Votes on Adoption      11 Yeas      1 Nay      7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

## B. *Business Activity Taxes*

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Many states and some local governments levy corporate income and franchise taxes on companies that either operate or conduct business activities within their jurisdictions. Income taxes are either levied as taxes on the net or gross income of businesses. A franchise tax is measured by the net income of a business. While providing revenue for states, these taxes also serve to pay for the privilege of doing business in a state. With the exception of Michigan, Nevada, South Dakota, Washington, and Wyoming, all states and the District of Columbia levy general corporate income taxes. The rates for income taxes range from 1% to 9.99%.<sup>29</sup>

With the growth of the Internet, companies are increasingly able to conduct transactions without the constraint of geopolitical boundaries. The increasing rate of interstate and international business-to-business and business-to-consumer transactions may

raise questions over states' ability to collect income taxes from companies conducting business within their jurisdiction. According to 15 U.S.C. § 381 (commonly referred to as "P.L. 86-272"), states may not levy taxes on the net income of sellers of tangible personal property derived from interstate commerce if the only business activities within the state consist of:

"(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation."<sup>30</sup>

*With the growth of the Internet, companies are increasingly able to conduct transactions without the constraint of geopolitical boundaries.*

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<sup>29</sup> Federation of Tax Administrators, See "State Corporate Income Tax Rates," (visited Mar. 2, 1999) <[http://www.taxadmin.org/fta/rate/corp\\_inc.html](http://www.taxadmin.org/fta/rate/corp_inc.html)>.

<sup>30</sup> 15 U.S.C.S. § 381 (a) Pub. L. No. 86-272 (1999).

### **Majority Proposal: Business Activity Taxes**

For purposes of clarifying the circumstances that determine 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) a seller's use of an ISP 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 Web site or catalogue to be returned to the other party's physical location within that state; (i) the advertisement of a seller's business location, telephone number, and Web site address; and (j) 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.

**Votes on Adoption      11 Yeas      1 Nay      7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

## C. Internet Access Taxes

A person may gain access to the Internet through one of two ways: (1) a direct connection, or (2) a dial-up connection. A direct connection generally connects one or more computers to the Internet on a permanent basis; businesses or individuals that need continuous connections generally use this type of connection. A dial-up connection typically supports only one computer's access to the Internet using either standard telephone lines or an integrated switched data network line for connectivity. The computer user directs his or her computer's modem to dial a specific telephone number that connects the user's computer to the modem and routing equipment (together, known as a "point of presence" or "POP") of an ISP. The local telephone company bills the computer user for this telephone service and the ISP bills the user separately for access to its service. Some ISPs charge for their services

based on the amount of time consumers are connected to their servers, others charge a flat fee for unlimited access time, some ISPs do not charge any fee, while still others offer consumers a choice of usage plans.

As provided under the Act, presently there is a moratorium on taxes on the sale of Internet access, unless such taxes were authorized by statute and enforced prior to the promulgation of the Act. The moratorium began on October 1, 1998 and will continue through October 21, 2001. At the time the Act passed, 12 states and the District of Columbia asserted that they levied sales taxes on Internet access. In addition, several Colorado cities and Tucson, Arizona have attempted to impose taxes on Internet access. Since the moratorium's enactment, several states have reversed their policies on taxing Internet access. At the writing of this report, eight states are assessing sales taxes on Internet access charges.

### **Majority Proposal: Internet Access Taxes**

Make 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.

**Votes on Adoption    11 Yeas    1 Nay    7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*







## D. Taxation of Telecommunications Services and Providers

The definition of “telecommunications” is continually evolving. Today, telecommunications refers to the network of technologies that provides for voice, data, and video transmissions. The telecommunications infrastructure that allows these transmissions to occur consists of copper wire, coaxial and fiber optic cable, and various wireless technologies. These technologies are changing, commingling, and expanding to provide faster and more efficient communication. The Internet, which relies on these technologies, is also propelling their growth.

Initially, the Internet was accessible to consumers only through the telephone system (using “dial-up” circuits and modems). Although dial-up connections are still the most widely used, consumers are seeking better access to existing services and the ability to use a broader array of information and services. This has led to increasing demand for “broadband communications.” Broadband refers to technologies that provide for faster transmission of larger amounts of data. To date, broadband Internet access is available through cable, fixed wireless, and satellite, as well as upgraded telephone lines, such as digital

subscriber lines technology. Consumer demand for broadband access is likely to rise as applications that take advantage of broadband capabilities come to market.

With the convergence of personal computers, telephones, and televisions, Internet access and other services will be distributed over telephone, cable, satellite, and wireless infrastructures. Increasingly, the distinctions between different technologies will blur, and the infrastructures used by these different

*Regulatory policies must keep pace with the fundamental changes that have occurred and will continue to occur in the telecommunications industry.*



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### *Taxation of Telecommunications Services and Providers*

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technologies will begin to compete in concurrent markets.

Regulatory policies must keep pace with the fundamental changes that have occurred and will continue to occur in the telecommunications industry. Policies that may have been suitable in a monopoly telephone environment must be re-examined in light of the rapidly changing and increasingly competitive marketplace. Among the important public policy issues deserving re-examination is the taxation of telecommunications providers, services, and infrastructure. Through testimony and written submissions, the Commission has identified the following four areas of federal, state, and local telecommunications taxation that are worthy of close examination:

1. The 3% federal excise tax on communications services;
2. State and local property taxes levied on telecommunications service providers;
3. State and local taxes on telecommunications service providers' business inputs; and
4. State and local transaction taxes on telecommunications.

### **1. The Federal Excise Tax**

The 3% federal excise tax on communications services was established in 1898 to assist with

financing the Spanish-American War and continued for the same purpose for World War I.<sup>31</sup> Before the widespread use of the telephone following World War II, the tax was considered a "luxury" tax. Although the tax was scheduled for elimination over several decades, American consumers continue to pay the 3% federal tax on all local and long-distance service today. In 1999, the tax raised approximately \$5 billion for the federal treasury. It is the third largest federal excise tax behind those on tobacco and alcohol.

There are several ways to access the Internet, including telephone, cable, and wireless infrastructures. The 3% federal excise tax applies to communications services, however, the boundary between taxable communications services and other telecommunications and information services is often unclear. This issue is becoming more complex as traditional and non-traditional service providers offer bundled services to consumers.

The 3% federal excise tax does not apply to sales of Internet access. However, the tax is typically applied to the local or long distance telephone system calls used to reach ISPs. Other technologies can be used to reach ISPs but may not be subject to this tax. This varying application of the tax should be a focus of attention.

### ***Majority Proposal: Federal Excise Tax***

Eliminate the 3% federal excise tax on communications services.

**Votes on Adoption      11 Yeas      1 Nay      7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

<sup>31</sup> Press Release, e-Freedom Coalition, "e-Freedom Coalition's Proposal to the Advisory Commission on Electronic Commerce," at 6 (Nov. 15, 1999).

## 2. State Property Taxes Levied on Telecommunications Service Providers

Many states impose property tax assessments on telecommunications service providers using the “unit valuation” method. The process of assessing property through unit valuation originated from the taxation of property held by railroads and utility companies during the 1800s. The underlying theory of the unit valuation method is that a company’s property is spread throughout many individual counties and, often, states. If each county valued only that portion of the total company’s property actually located within its jurisdiction, the sum of all such values would likely be considerably lower or higher than the fair market value of the entire unit. Therefore, in an attempt to more accurately capture the true value of the property, states began basing tax assessments on their share of the total value of the property of the entire company or “unit valuation.” Implicitly, unit valuation can capture the going concern value of a business and not just the fair market value of tangible property. It can encompass not only the value of the physical assets, but the value of a firm’s trade name, patents, licenses, contracts, customer lists, goodwill, assembled work force, distributor relationships, supplier relationships, software, trade secrets, and similar assets. Given the features of the industry, it is appropriate to question whether the unit valuation methods



used in the states result in valuations that are fair, especially when compared to other utility and non-utility businesses.

Apart from the issue of fair and consistent market valuation, there are three other areas where telecommunications companies are not treated the same as many other businesses. First, some states use a different statutory assessment level for telecommunications property to determine the portion of the market value to be used for tax purposes. Second, some states apply different property tax rates to the assessed value of telecommunications company property than to other industry sectors. And third, some states have repealed personal property taxes for all businesses except for telecommunications companies. All of these practices call into question whether the disparate property tax burden being borne by this industry is fair, especially when compared to the business property of a similar nature.

### ***Majority Proposal: State Property Taxes on Telecommunications Service Providers***

Eliminate the excess tax burdens on telecommunications real, tangible, and intangible property.

**Votes on Adoption    11 Yeas    1 Nay    7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

## Domestic Tax Issues & Proposals

### *Taxation of Telecommunications Services and Providers*



## Domestic Tax Issues & Proposals

### *Taxation of Telecommunications Services and Providers*

### 3. State and Local Taxes on Telecommunications Service Providers' Business Inputs

In addition to property taxes, most state and local governments levy transaction taxes on telecommunications equipment. While many state and local governments levy taxes on several types of business inputs, these taxes generally do not apply to products or services purchased for resale or incorporated in another product or service that will ultimately be sold at retail. The exemption for business inputs follows the theory that only the ultimate consumption of a product or service is taxed; therefore, it avoids the pyramiding of taxes. Many

states exempt some business inputs for certain industries but do not necessarily extend a similar exemption to purchases of telecommunications equipment. In addition, some states do not exempt sales for resale of telecommunications services, thereby taxing the service multiple times.



#### ***Majority Proposal: State and Local Taxes on Telecommunications Service Providers' Business Inputs***

Afford similar treatment of telecommunications infrastructure in states that exempt purchases of certain types of business equipment from the sales and use taxes.

**Votes on Adoption**      **11 Yeas**      **1 Nay**      **7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

### 4. State and Local Transaction Taxes on Telecommunications

State and local governments levy transaction taxes on the sale of telecommunications service to consumers. These transaction taxes are complex and costly to comply for telecommunications service companies with a national presence and are discriminatory in application. Presently, a national service provider might have to

file as many as 55,748 tax returns to meet the obligations of all state and local jurisdictions.<sup>32</sup> The effective transaction tax rates that apply to telecommunications services exceed the effective transaction tax rate applied to most other sales. Average effective state and local transaction tax rates are 14.15% as compared to 6.31% for most other sales.<sup>33</sup> While telecommunications service companies bear the initial

<sup>32</sup> Committee on State Taxation, *50-State Study and Report on Telecommunications Taxation* at 5 (Sept. 7, 1999).

<sup>33</sup> *Id.* at 2.

burden for calculating and remitting these taxes, the actual taxes are typically imposed on consumers, passed on as surcharges, or passed on in the form of higher prices on consumers' bills.

Also, many state and local governments apply different tax structures depending on the type of firm offering the telecommunications services. Different tax rates could apply to telecommunications services provided by traditional wire line, cable, Internet, or wireless firms. If these different technologies are being used to provide essentially the same basic service, taxing them at different rates raises questions of both tax efficiency and competitive neutrality. In addition, as service providers offer a bundle of

services for a flat fee—e.g., Internet access, local and long distance, video, and wireless—different questions arise as to the form of tax and its rate.



## Domestic Tax Issues & Proposals

### *Taxation of Telecommunications Services and Providers*

### ***Majority Proposal: State and Local Transaction Taxes on Telecommunications***

1. Encourage state and local governments to work with and through NCCUSL in drafting a uniform telecommunications state and local excise tax act, within three 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 service 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; and
- (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) telecommunications service providers would be held harmless if they rely on the database; and
- (f) provide for vendors' compensation.

2. Establish a process (or timeline) for states to adopt the uniform telecommunications state and local

## Domestic Tax Issues & Proposals

### *Taxation of Telecommunications Services and Providers*

excise tax act and to remove excess and multiple taxation of telecommunications services. States that fail to adopt the act and to remove the excess and multiple taxation within three years after the expiration of the moratorium in the Internet Tax

Freedom Act 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.

**Votes on Adoption    11 Yeas    1 Nay    7 Abstentions**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

## E. *Constitutional Redress Methods*

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The Internet presents the ability for businesses of all sizes to conduct remote commerce all over the world. New opportunities abound to promote and conduct business with consumers that were previously out of market reach due to physical limitations. With the opening of these markets, there is increasing potential for businesses to have tax obligations in multiple states and for states to apply taxes to these out-of-state businesses and consumers. These taxes include transactional and business activity taxes.

The 10<sup>th</sup> Amendment to the Constitution provides states the authority to collect taxes not prohibited elsewhere under the Constitution.<sup>34</sup> Sometimes taxpayers believe state taxes are prohibited by other constitutional provisions such as the Commerce Clause, the 14<sup>th</sup> Amendment, or the 1<sup>st</sup> Amendment. As a result, disagreements occur over the legality of these tax applications. Some of the disagreements can lead to litigation, either because a taxpayer feels the taxes are unconstitutional or because a taxing jurisdiction believes that a business is not complying with its tax obligations.

Normally, a citizen of one state

making a federal claim against another state (or state official) can gain access to the federal courts via diversity or federal claims jurisdiction. In the tax environment, however, the Tax Injunction Act<sup>35</sup> requires taxpayers to proceed in the courts of the taxing state, and then pursue an appeal to the U.S. Supreme Court directly once in-state remedies have been exhausted. The Tax Injunction Act applies so long as a “plain, speedy and efficient remedy may be had” in the state courts.

In practice, even if a tax is found to be unconstitutional, state courts may or may not require refunds to be paid. The U.S. Supreme Court has indicated its decisions are to be given retroactive application and that states must provide “meaningful backwards-looking relief,” for taxes that are declared unconstitutional.<sup>36</sup> Frequently, however, the remedy may involve a prospective change in law, such as altering a discriminatory tax. Furthermore, under current federal law, successful taxpayers are not entitled to attorney’s fees and costs. However, state law can and sometimes does allow for attorney’s fees.

While discussed during Commissioners’ deliberations, no formal votes were taken on this issue.

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<sup>34</sup> U.S. Const. amend X (1999).

<sup>35</sup> *Tax Injunction Act*, 28 U.S.C. § 1341 (2000).

<sup>36</sup> *McKesson, Corp. v. Division of Alcoholic Beverages and Tobacco, Department of Business Regulation of Florida, et al*, 496 U.S. 18 (1990).





## F. *Digital Divide*

While there has been explosive growth in the IT sector, certain members of our community still have yet to participate fully in the new digital economy. The “digital divide” refers to the disparity between individuals with access to a computer (or other evolving technologies, such as wireless, etc.) hardware, infrastructure and critical information and those without such access and has been called one of the most challenging social problems America faces in this new century. This disparity may result from economic, geographic, educational, age, and cultural differences. Computers (or other evolving technologies, such as wireless, etc.), telecommunications infrastructure, and Internet access are facilitating access to the growing amounts of digital information. While the Internet is providing new avenues for communication, learning, and commerce, there is a substantial gap between participants and non-participants in this medium.

A 1999 study by the U.S. Department

of Commerce’s National Telecommunications and Information Administration (“NTIA”), “Falling Through the Net: Defining the Digital Divide,” people with a college degree are over eight times more likely to have a computer than those who are less educated.<sup>37</sup> Over 60% of those with a college education use the Internet as opposed to only about 7% for those with a high school degree or less.<sup>38</sup> NTIA’s research also describes a growing divide for in-home Internet access among minorities, with an increase in the gap between Caucasian and African-American households of 37.7%<sup>39</sup> and an increase by 37.6%<sup>40</sup> between Caucasian and Hispanic households between 1997 and 1998.<sup>41</sup> Fortunately, the rapid embrace of these new technologies is

*The “digital divide” ... one of the most challenging social problems America faces in this new century.*



<sup>37</sup> U.S. Department of Commerce, National Telecommunications and Information Administration, “Falling Through the Net: Defining the Digital Divide,” at 1 (July 1999) (rev. Nov. 1999).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

## Domestic Tax Issues & Proposals

### *Digital Divide*

helping to stimulate more in-home usage by driving hardware prices to more affordable levels, while free Internet access is allowing more individuals who otherwise would not be able to choose a service, the ability to log on. The NTIA study did report some encouraging news; the report reveals a 50% increase<sup>42</sup> in Internet usage across-the-board, regardless of income, race or national origin.

The inability of some of our citizens to participate in Internet-based activities is very significant and worthy of serious attention. As discussed above, the marketplace is moving to address many of those concerns, at least in part. Public-private partnerships are also contributing resources to address these concerns.<sup>43</sup> Power Up, a coalition of industry, non-profit groups and the U.S. Government provides free or below market-cost access to computers and Internet accounts and will help insure Internet access for low-income families. ServInt, of McLean, Va., operates the "ServInt FreeNet" program, through which they provide free Web site and e-mail hosting for non-profit and community groups. Additionally, the Gates Foundation is giving millions of dollars in grants to libraries in low-income areas to provide computers, Internet access, and technical training. Many states are also implementing programs to provide access to computers and the Internet as well as training and education.

The issue, however, is greater than one of just access. Once access is attained, the use of the Internet and associated technologies must be socially

worthwhile and economically beneficial in order for it to truly become a universal tool of communication and commerce. Many of the Commissioners expressed the need to address the Digital Divide as part of any discussion of taxing e-commerce. The application of state and local transaction taxes, aside from being regressive in nature, also serves to erect barriers to access that prevent some of the most disenfranchised citizens, from accessing the opportunities available online. Reducing these marginal costs, as well as establishing training and incentive programs for states and localities, provides local governments with the



maximum flexibility needed to implement effective programs.

Finally, the Commission believes that Congress should continue gathering data for empirical research that will inform federal, state, and local policymakers on measures that will lead to the reduction, and eventual elimination, of the Digital Divide by empowering families in rural America and inner cities to participate in the Internet economy.

<sup>42</sup> *Id.*

<sup>43</sup> A clearinghouse of public-private efforts can be found at <<http://www.digitaldivide.gov>>.

## ***Recommendations: Digital Divide***

- Clarify federal welfare guidelines expressly to permit the states to spend TANF surpluses (unobligated balances) to provide needy families access to computers and the Internet and to provide training in computers and Internet use.

- Encourage states and localities to partner with private technology companies to make computers and the Internet widely accessible for needy families, libraries, schools, and community centers, and to train needy families how to use computers and the Internet. Incentives for these partnerships may include:

- federal and state tax credits and incentives for private technology companies that partner with state and local governments; and

- federal matching funds for state and local expenditures.

- Encourage the Administration and Congress to continue gathering data for empirical research that will inform federal, state, and local policymakers on measures that will lead to the reduction, and eventual elimination, of the Digital Divide by empowering families in rural America and inner cities to participate in the Internet economy.

**Votes on Adoption    15 Yeas    3 Abstentions    1 Not Present**

*The proposal passed by more than 2/3rds (15) and is considered a finding or recommendation.*

## **Domestic Tax Issues & Proposals**

### ***Digital Divide***



## G. Privacy Implications of Internet Taxation

The Commission process has shown that proposals to increase state and local authority over the taxation of e-commerce have significant privacy ramifications. Furthermore, technological advances will likely allow for increased tax collection efficiencies, however other

important principles — such as increased exposure of individual privacy — must be balanced against what is technologically possible. The issue of consumer privacy is one that pervades all aspects of e-commerce, and not just the tax administration system.

### *Recommendations: Privacy*

- Explore privacy issues involved in the collection and administration of taxes on e-commerce, with special attention given to the repercussions and impact that any new system of revenue collection may have upon U.S. citizens and the steps taken in systems developed to administer taxes on

e-commerce to safeguard and secure personal information.

- Take great care in the crafting of any laws pertaining to online privacy (if any such laws are necessary) to avoid policy missteps that could endanger U.S. leadership in worldwide e-commerce.

**Votes on Adoption    16 Yeas    1 Abstention    2 Not Present**

*The proposal passed by more than 2/3rds (16) and is considered a finding or recommendation.*

*The issue of consumer privacy is one that pervades all aspects of e-commerce.*





## *International Tax Issues and Tariffs*

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The Internet is a borderless marketplace for commerce and ideas, which crosses local, national, and global frontiers. This area of seamless cyberspace presents unique challenges for national governments, particularly with respect to the application of tariffs and taxes. Policies adopted in this area have important implications on the continued growth of both e-commerce and liberalized trade.

### **1. Tariffs**

An important issue before the Commission involves the application of tariffs, or customs duties, on electronic transmissions. By way of background, a tariff is a measure imposed by national

governments on the importation of goods at the border and is calculated based on its country of origin rather than its place of consumption. Normally, a country will impose a tariff—which has the effect of raising the price of imports relative to similar domestic products—as a way of protecting a domestic industry. Through customs duties or tariffs, countries impose a differential burden at the border, which often has the effect of disadvantaging imports.

The imposition of tariffs on electronic transmissions presents a unique situation. Electronic transmissions—consisting of bits and bytes, zeros and ones—encompass international data flows and the content embedded in that data. For instance, an electronic transmission could include digitally-transmitted products ordered via the Internet (such as downloadable software), but would not include goods ordered via the Internet that were physically delivered (such as a camera or a book). Unlike physical goods, the bits and bytes of an electronic transmission are not readily identifiable and, traveling in cyberspace, do not “stop” at the border. As a result, the imposition of tariffs “at the virtual border” on unidentifiable transmissions raises several logistical and privacy concerns, and efforts to do so would create an unnecessary burden.



The U.S. policy over the past 50 years has been to use international mechanisms to progressively lower duties and eliminate trade distortions. In line with this policy, the U.S. Government has been at the forefront of the effort in the World Trade Organization (“WTO”) to promote a moratorium on the imposition of customs duties on electronic transmissions, which includes digitally-

transmitted products (not physical goods) ordered via the Internet. Member governments of the WTO adopted such a moratorium on a temporary basis in May 1998. Although no formal action was taken at the December 1999 WTO Ministerial, this moratorium continues, and the United States does not expect any country to deviate from its current practice.

### ***Recommendation: Tariffs***

The continuation and enhancement of free trade is of fundamental importance to the continued economic growth of the United States. The Administration has taken a leadership role on the issue of tariffs and advocates a standstill on tariffs on the Internet. The tariff system must facilitate the continuation and

growth of e-commerce. Tariffs negatively impact all customers around the world. Everything possible should be done to guarantee that other countries do not adopt rules that discriminate against the United States.

Support implementing and making permanent a standstill on tariffs at the earliest possible date.

**Votes on Adoption**      **18 Yeas**      **1 Nay**

*The proposal passed by more than 2/3rds. It is considered a finding or recommendation.*

### ***Majority Proposal: Tariffs***

Support the formal, permanent extension of the World Trade Organization’s current moratorium on tariffs and duties for electronic transmissions.

**Votes on Adoption**      **11 Yeas**      **7 Abstentions**      **1 Not Present**

*The proposal passed by a majority. It is not considered a finding or recommendation.*

## **2. International Taxes on Goods and Services**

Another major issue before the Commission is the potential impact of national taxation policies on e-commerce conducted internationally. While internal taxation policies raise domestic revenues, the international implications of those policies may impede or limit the potential international growth of e-commerce. Conversely, other

governments’ tax collection policies may impede the growth of e-commerce for U.S. businesses and may hinder the ability of smaller businesses to compete globally.

To address these concerns, business and government leaders from the United States and other countries are participating in on-going discussions held by the OECD. Thus far, the OECD has created five Technical Advisory



Groups (“TAGs”)<sup>44</sup> to address the taxation of e-commerce. To guide the work of the international representatives on these TAGs, the OECD has outlined several basic taxation principles:

*Neutrality:* goods and services should be taxed the same regardless of the mechanism through which these items are sold;

*Efficiency:* compliance costs for businesses and governments should be kept as minimal as possible;

*Certainty and Simplicity:* businesses and taxpayers should be able to easily interpret tax compliance obligations;

*Effectiveness and Fairness:* taxes should be levied at the appropriate point of sale and the potential for evasion and avoidance should be minimized; and

*Flexibility:* tax systems should be able to keep pace with technical and commercial development.

The OECD continues to hold discussions to foster communication on adapting and harmonizing tax systems



to and with e-commerce.

The European Union (“EU”) is participating in these OECD discussions.

The European Commission (“EC”) under the EU is in the process of adapting its value-added taxes (“VAT”) system to all goods and services, regardless of the medium through which these items are sold. The VAT is levied at the place of consumption for the particular good or service. Each member state of the EU determines its own rate for the VAT

on items sold. For tangible items traveling into the EU, either the supplier of the item or the delivering carrier under contract with the supplier, calculates and remits the VAT according to the destination of the item. For items that are not taxed at the point of sale, such as digitally-transferred goods and services, the EU presently relies on self-assessment (known as “reverse charge”). Reverse charges are declared and remitted by the consumer of the untaxed item. Presently, the VAT accounts for almost a fifth of the tax receipts for each of the EU’s member states, and contributes 44% of the EC’s budget.<sup>45</sup>

The EC recognized the difficulty in enforcing tax policies with the remote and electronic nature of the Internet. To ensure the viability of the process, the EC is considering a system of registration for businesses. Under this



<sup>44</sup> The TAGs’ focuses are, respectively: Technology, Professional Data Access, Consumption Taxes, Business Profits, and Income Characterization.

<sup>45</sup> European Commission, Directorate-General XXI, Working Party N° 1 “Harmonization of Turnover Taxes Working Paper,” at 2 (June 8, 1999).

proposed registration process, companies that conduct a certain threshold of business within the EC would be required to register with taxing authorities, and collect and remit the VAT to the proper member countries. In testimony before the Commission, the director of tax policy at the EC outlined the goal of the EC to have U.S. businesses register with EC tax authorities for the purposes of collecting and remitting the VAT on items purchased over the Internet and consumed within the EU.<sup>46</sup>

Some international government representatives have recommended imposing “bit taxes” on electronic transmissions.<sup>47</sup> As suggested, a bit tax would be an international tax, on digital information according to the size of the data transferred. Proposals for bit and

byte taxes have met with little support by government officials for fear that such impositions would discourage the growth of the Internet.

In the Commission’s discussions of International tax issues, there has been overwhelming support for the principles outlined above, particularly nondiscriminatory and neutral taxation of e-commerce. Harmonization of jurisdictional and administrative rules was also encouraged in order to coordinate collection and remittance of consumption-type taxes in cross-border transactions. The Commission voiced respect, approval, and continuing encouragement for the OECD’s leadership role in engaging businesses worldwide in the process of identifying and resolving cross-border taxation issues.

### *Majority Proposal #1: International Taxes on Goods and Services*

1. Recognize the OECD’s leadership role in coordinating international dialogue concerning the taxation of e-commerce, affirm support for the principles of the OECD’s framework conditions for taxation of e-commerce, and support the OECD’s continued role as the appropriate forum for (1) fostering effective international dialogues concerning these issues and (2) building international consensus on the following principles:

- No new taxes should be applied to e-commerce, rather existing taxation principles should be applied and, if necessary, internationally-accepted rules of taxation should be clarified to accommodate changing forms of

business activity;

- New or modified tax rules, within the existing framework of tax principles, should be crafted to achieve neutrality by treating economically similar income and transactions similarly (whether earned electronically or conducted through non-electronic means), thereby avoiding economic and competitive distortions;
- Any taxation of Internet transactions should neither distort nor hinder commerce and any clarification of existing tax rules should not operate to discriminate against e-commerce, either in the form of larger tax obligations or greater administrative duties than

<sup>46</sup> Michael Aujean, European Commission, (Testimony before the Advisory Commission on Electronic Commerce), (Dec. 14, 1999).

<sup>47</sup> United Nations, *Human Development Report 1999*, at 10 (July 1999).

apply to similar activities in traditional commerce;

- Any tax system imposed on e-commerce should be simple and transparent. It should be efficient, easy to implement, and minimize burdensome record keeping and costs for all parties;
- The OECD should continue the process of involving e-commerce stakeholders—particularly, through the involvement of the TAGs established by the OECD—in identifying issues impacting the imposition and collection of taxes on e-commerce;
- Any modifications to existing rules or adoption of new rules to address e-commerce taxation issues should be carefully thought out through consultation with the

business community and other affected parties before modified or adopted; and

- All nations should be encouraged to defer modification of their tax systems in order to allow for the development of an international consensus concerning taxation of e-commerce.

2. Encourage and support (including adequately funding) the U.S. Government’s efforts to further international dialogue concerning the taxation of e-commerce, which are consistent with the principles outlined above.
3. Refrain from adopting legislative proposals affecting international transactions or activities that are inconsistent with the principles enumerated above.

**Votes on Adoption    11 Yeas    7 Abstentions    1 Not Present**  
*The proposal passed by a majority. It is not considered a finding or recommendation.*

The Commission process has shown a lack of discussion and knowledge on how domestic decisions—particularly those surrounding state and local taxation of Internet sales and telecommunications—will affect the competitiveness of U.S. firms in the global marketplace, competing for both foreign and U.S. consumers.

Appropriate committees of Congress should explore these issues in detail.

This exploration should include not only an assessment of how domestic taxes and tax burdens will affect U.S. competitiveness, but also an assessment of taxes imposed by foreign governments on Internet sales and telecommunications and the potential impact on U.S. firms if our domestic tax policies are adopted as a model by foreign national, provincial, and local governments.

### ***Majority Proposal #2: International Taxes on Goods and Services***

Congress should increase its oversight of the international ramifications of domestic Internet commerce decisions.

**Votes on Adoption    11 Yeas    8 Abstentions**  
*The proposal passed by a majority. It is not considered a finding or recommendation.*



## Appendix A

# *Personal Statements by Commissioners*

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To view the statements submitted by the Commissioners click on the applicable link below:

Statement of Mr. Andal

<http://www.ecommercecommission.org/andal.pdf>

Statement of Mr. Armstrong

<http://www.ecommercecommission.org/armstrong.pdf>

Statement of Governor Gilmore

<http://www.ecommercecommission.org/gilmore.pdf>

Statement of Messrs. Guttentag, Novick and Pincus

<http://www.ecommercecommission.org/gnp.pdf>

Statement of Mr. Harris

<http://www.ecommercecommission.org/harris.pdf>

Statement of Ms. Jones

<http://www.ecommercecommission.org/jones.pdf>

Statement of Mayor Kirk

<http://www.ecommercecommission.org/kirk.pdf>

Statement of Governor Leavitt

<http://www.ecommercecommission.org/leavitt.pdf>

Statement of Mr. Lebrun

<http://www.ecommercecommission.org/lebrun.pdf>

Statement of Governor Locke

<http://www.ecommercecommission.org/locke.pdf>

Statement of Mr. Norquist

<http://www.ecommercecommission.org/norquist.pdf>

Statement of Mr. Parsons

<http://www.ecommercecommission.org/parsons.pdf>

Statement of Mr. Pittman

<http://www.ecommercecommission.org/pittman.pdf>

Statement of Mr. Pottruck

<http://www.ecommercecommission.org/pottruck.pdf>

Statement of Mr. Sidgmore

<http://www.ecommercecommission.org/sidgmore.pdf>

Statement of Mr. Sokul

<http://www.ecommercecommission.org/sokul.pdf>

Statement of Mr. Waitt

<http://www.ecommercecommission.org/waitt.pdf>



## Appendix B

# Glossary of Terms

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**Advisory Commission on Electronic Commerce:** A federal Commission comprised of 19 congressionally appointed members. It was established by the Internet Tax Freedom Act (47 U.S.C.S. § 151 Sec. 1102) to conduct a thorough study of federal, state, local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities.

**Audit:** A formal examination of the accounts or financial situation of an organization or an individual.

**Bit Tax:** A tax on e-commerce expressly imposed on or measured by the volume of digital information transmitted electronically, or the volume of digital information per unit of time transmitted electronically. The bit tax does not include taxes imposed on the provision of telecommunications services.<sup>1</sup> (Byte Tax is a similar tax measured by bytes of information instead of bits.)

**Brick and Mortar Business:** A firm that operates with a physical storefront and conducts business through physical mechanisms. Also commonly referred to as a “main street retailer.”

**Broadband:** A network of technologies that provide for faster transmission of larger amounts of data. To date, broadband Internet access is available through cable, fixed wireless and satellite, as well as upgraded

telephone lines, such as digital subscriber lines technology.

**Burden:** Expenses incurred, whether monetary, personnel, or administrative to comply with tax policy.

**Business Activity Taxes:** Taxes remitted by business to comply with the tax code of the jurisdiction.

**Business-to-Business Transaction:** The sale or exchange of goods or services between two businesses.

**Business-to-Consumer Transaction:** The sale or exchange of goods or services between a business and a private consumer.

**Click and Mortar Business:** A firm that conducts business through both physical and electronic mechanisms.

**Commerce Clause:** Article I, § 8 of the U.S. Constitution. According to this clause, Congress has the right to “regulate commerce with foreign nations, and among several states, and with the Indian tribes.”

**Consumer Privacy Rights:** This concept generally refers to an individual’s expectation or right of privacy when involved in any type of business or communication.

**Consumption Tax:** A tax imposed on a good or service in the jurisdiction where the consumption takes place, rather than at the point of production.

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<sup>1</sup> Internet Tax Freedom Act, 47 U.S.C.S. § 151, Sec. 1104 (1998).

**Cyberspace:** A term referring to the Internet.

**Digital:** A system in which all information can be broken down into 0s and 1s. Digital transmission allows information to be separated into packets and recomposed at the destination.

**Digital Divide:** The disparity between individuals with access to hardware, infrastructure, and information and those without such access. This disparity may result from economic, geographic, educational, age, and cultural differences.

**Digital Subscriber Lines (DSL):** Upgraded telephone lines using sophisticated modulation schemes to carry data over copper wires.

**Digitized Goods:** Goods that are delivered electronically, e.g., a software application or music downloaded from a Web site.

**Discriminatory Tax:** See appendix F, section 1104 (2) for definition.<sup>2</sup>

**Download:** Process by which an electronic file or software may be saved to a computer.

**E-business:** A firm that operates without a physical storefront and conducts business solely over the Internet. Also commonly referred to as a “virtual merchant.”

**Electronic Commerce (e-commerce):** “[A]ny transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer or delivery of property, goods, services, or information, whether or not for consideration and includes the provision of Internet access.”<sup>3</sup>

**Excise Tax:** A direct tax imposed on the sale of one or more specific types of services, such as telecommunications services.

**Franchise Tax:** An excise tax on the privilege of conducting business within a state, usually measured by net income.

**GDP (Gross Domestic Product):** The output of goods and services produced by labor and property located in the United States.

**Harmonization:** The process to clarify tax policy among and between different taxing jurisdictions.

**Host (as in hosting a Web Site):** A computer connected to the Internet that stores digital information.

**Income Tax:** Tax imposed on the taxable income of a taxpayer. Taxable income is based upon gross income, which is defined by the IRS Code as all income, from whatever source derived.

**Intangible Goods:** Property and services other than tangible physical assets.

**Internet:** Collectively, the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information.<sup>4</sup>

**Internet Service Provider (ISP):** A company that provides access to the Internet to organizations and/or individuals. Access services provided by ISPs may include: webhosting, email, and VoIP (voice over IP).

**Interstate Commerce:** Business conducted beyond the boundaries of a single state.

**Intrastate Commerce:** Business conducted within the boundaries of a single state.

**Jurisdiction:** The authority of a sovereign power to govern or legislate [or collect taxes]. Traditional jurisdictional authority has been based on geo-political boundaries.

**Modem:** A device that allows a computer to connect to the Internet.

**Multiple Tax:** Any tax imposed on the same good, property, or service that is also subject to tax imposed by another jurisdiction, (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions.<sup>5</sup>

**Network:** A group of two or more computer systems linked together.

**Neutrality:** The practice of treating economically similar income and transactions similarly (whether earned or conducted through electronic or non-electronic

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*



means), thereby avoiding economic and competitive distortions.

**Nexus:** The threshold of contact required between a taxpayer and a jurisdiction.

**Property Tax:** A tax levied on the value of real or personal property owned by a taxpayer on a specific date.

**Remote Sales:** Sales that are conducted by mail, phone, computer, Internet, or any means other than at a physical storefront.

**Reverse Charge:** A self-assessed method of tax collection used in the EU for items that are not taxed at the point of sale, such as digitally-transferred goods and services. Reverse charges are declared and remitted by the consumer of the untaxed item.

**Sales Tax:** A tax applied generally to the sale or lease, within the taxing jurisdiction, of certain goods and services, which is typically collected by the vendor at the time of sale and remitted to the taxing jurisdiction on monthly returns.

**Simplification:** Reducing the complexity of the tax code. Such simplification may include: clearer definitions, classifications, exemptions, rates and jurisdictions.

**Server:** A computer or device on a network that manages network resources.

**Tangible Goods and Services:** Physical property and services.

**Transaction Tax:** Tax imposed upon, or measured by, the amount paid for a product or service.

**Tax:** Any charge imposed by a government entity for the purpose of generating revenues.

**Tariff:** A duty levied on goods produced abroad at the time of importation.

**Tax Credit:** An allowance against the tax itself. Tax credits directly reduce tax liability.

**Tax Exemption:** A deduction allowed a taxpayer because of status or circumstance rather than because of specific economic costs or expenses during the taxable year.

**Tax Filing:** Submission of documents, such as tax returns and refund claims, (and taxes due) to taxing authorities.

**Temporary Assistance to Needy Families Program (TANF):** TANF provides assistance in the form of block grants and promotes work opportunities to needy families by granting states the federal funds and wide flexibility to develop and implement their own welfare programs.

**Uniformity:** Clarity and consistency within a tax code.

**Unit Valuation:** Method for assessing tax obligations that may capture the going concern value of a business and not just the fair market value of a business, and not just the fair market value of tangible property. It can encompass not only the value of the physical assets, but the value of a firm's trade name, patents, licenses, contracts, customer lists, goodwill, assembled work force, distributor relationships, supplier relationships, software, trade secrets and similar assets.

**Use Tax:** A tax that applies generally to the use or consumption of goods or services purchased outside the taxing jurisdiction for use within the taxing jurisdiction. A use tax is generally complementary to, and imposed at the same rate as, the jurisdiction's sales tax.

**Value Added Tax (VAT):** An incremental excise that is levied on the value added at each stage of the processing of a raw material or the production and distribution of a commodity and that typically has the impact of a sales tax on the ultimate consumer.

**Web Site:** A unique address on the World Wide Web that provides users with digital information.



## Appendix C

# Contributors to the Discussion

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*McKesson, Corp. v. Division of Alcoholic Beverages and Tobacco, Department of Business Regulation of Florida, et. Al*, 496 U.S. 18 (1990)

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All documents will remain on file until May 12, 2000, with the Advisory Commission on Electronic Commerce, 3401 North Fairfax Drive, Room 331, Arlington, VA 22201, (703) 993-8049. After that date, documents will be available from the Center for Legislative Archives, 7th and Pennsylvania Ave., NW, Washington, DC 20408, (202) 501-5350. In addition, documents available electronically may be accessed at the Commission's Web site, [www.ecommercecommission.org](http://www.ecommercecommission.org), until June 1, 2001.

\*Documents not available electronically.

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- David Aldridge, *Comments from the Iowa League of Cities*, (September, 1999)\*
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- Lee Brown, *Comments from the City of Houston*, (January 10, 2000)\*
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- Danielle Bujnak, *Proposal for the Advisory Commission on Electronic Commerce*, (November 15, 1999)
- David Bullington, *Testimony to the Commission in San Francisco*, (December 14, 1999)
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- Maurice Mizrahi, *Comments from Maurice Mizrahi*, (December 14, 1999)\*
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- Ronald Nehring, *Repeal the Gore Tax*, (May 21, 1999)\*
- Mark Newburger, *Comment from Apollo Telemedicine*, (August 16, 1999)\*
- Michael Noll, *Comments from the City of Signal Hill, CA*, (October 29, 1999)
- Norris Nordvold, *Comments from the City of Phoenix, AZ*, (November 12, 1999)
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- Russell Schrader, *Comments from VISA*, (October 29, 1999)
- Charles Scoma, *Letter and Resolution from the City of North Richland Hills, TX*, (January 18, 2000)\*
- Joe Shaw, *Comments from the City of Lancaster, SC*, (November 9, 1999)
- Edwin Shimizu, *Executive Summary - GTE Service Corporation*, (August, 1999)
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- Frances Smith, *Preliminary Statement of Frances B. Smith*, (September 9, 1999)
- Fred Smith, Jr., *Draft Remarks—Panel on International Taxes, Tariffs & Duties, Associated with Electronic Commerce*, (September 15, 1999)
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- Jeanie Smith, *Comments from Mississippi Municipal League*, (November 15, 1999)
- Mary Smith, *Comments on behalf of the City of Springfield, MO*, (September, 1999)
- Terry Smith, *Comments from Drop Tine Outdoors, LLC*, (December 16, 1999)
- Richard K. Smith, *Letter from the Finance Department, City of Hoover, AL*, (January 26, 2000)\*
- Mark Stackpoole, *ATRACS Corporation*, (November 11, 1999)
- Dean Stansel and Stephen Moore, *The State Spending Spree of the 1990s*, (September, 1999)\*
- Daniel Sullivan, *Submission by TAXWARE International, Inc.*, (August 31, 1999)
- Daniel Sullivan, *Testimony to the Advisory Commission on Electronic Commerce in San Francisco*, (December 14, 1999)
- Daniel Sullivan, *Adapting Tax Technology to the Internet — the eCommerce Transaction Tax Server*, (November 12, 1999)
- Rebecca Sullivan, *Comments from the International Council of Shopping Centers*, (November 11/1999)\*
- Orson Swindle, *Address to the Advisory Commission on E-Commerce*, (June 22, 1999)
- Joseph Taricani, *The New Millennium for Government Revenue Recovery*, (August, 1999)
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Theodore Voorhees, *Comments from the City of King, NC*, (September, 1999)\*

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Richard White, *Comments from iPolitics.com*, (December, 1999)\*

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Christopher Wysocki, *Testimony presented on December 14th at the San Francisco Meeting*, (December 14, 1999)



## Appendix D

# *Witness List/Expert List*

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### *Witnesses*

*(Invited by the Commission to testify at a meeting.)*

**Donald S. Abelson,**

Assistant U.S. Trade Representative for Industry and Communications  
Office of the U. S. Trade Representative

**Dean F. Andal,** Chairman

California Board of Equalization  
and Commissioner Advisory Commission on Electronic Commerce

**Michel Aujean,** Director of Tax Policy  
European Commission

**Charles E. Bayless,** President and CEO  
Illinova Power

**Joseph Brooks,** Councilman

City of Richmond, Virginia  
on behalf of The Council of State Government, International City and County Management Association, National Conference of State Legislators, National Association of Counties, National Governors' Association, National League of Cities, and the U. S. Conference of Mayors

**Dan Bucks,** Executive Director  
Multistate Tax Commission

**David Bullington,** Vice President  
Tax Department, Wal-Mart

**Kaye Caldwell,** Public Policy Director  
CommerceNet

**Annabelle Canning,** Vice President  
Committee on State Taxation

**Gary Cornia,** Co-Chair  
National Tax Association Project

**Joseph R. Crosby,**  
Senior Manager, State and Local Tax Legislative Services  
Ernst & Young LLP  
on behalf of the eCommerce Coalition

**Katrina Doerfler,**  
Senior Manager for Planning and External Tax Affairs  
Cisco Systems, Inc.

**Harley Duncan,** Executive Director  
Federation of Tax Administrators

**James R. Eads,** Partner  
Ernst & Young, LLP

**Jeffrey A. Eisenach,** President  
Progress and Freedom Foundation

**William Fox, Ph.D.**  
Center for Business & Economic Research  
University of Tennessee

**James M. Goldberg,** General Counsel  
North American Retail Dealers Association

**Austan Goolsbee, Ph.D.**, Professor  
Graduate School of Business  
University of Chicago

**Joseph H. Guttentag**,  
Senior Advisor to the Assistant Secretary for Tax Policy  
U. S. Department of Treasury  
and Commissioner, Advisory Commission on  
Electronic Commerce

**Walter Hellerstein, Ph.D.**, Professor of Law  
University of Georgia

**Kendall Houghton**  
Alston & Bird, LLP

**George Isaacson, Counsel**  
The Direct Marketing Association

**William Janklow, Governor**  
South Dakota

**Randy Johnson**, Chair  
Board of Hennepin County Commissioners  
on behalf of The Council of State Government,  
International City and County Management  
Association, National Conference of State  
Legislators, National Association of Counties,  
National Governors' Association, National League  
of Cities, and the U. S. Conference of Mayors

**R. Bruce Josten**,  
Executive Vice President, Government Affairs  
U. S. Chamber of Commerce

**Frank G. Julian**,  
Operating Vice President & Tax Counsel  
Federated Department Stores

**Raymond J. Keating**, Chief Economist  
Small Business Survival Committee

**Matthew Harris Kisber**  
Tennessee State Representative  
on behalf of the National Conference of State  
Legislatures

**Keith G. Landry**, General Attorney  
Bellsouth Corporation  
on behalf of Air Touch, ALLTEL, AT&T, Bell Atlantic,  
BellSouth, CommNet Cellular, Global Crossing, GTE,  
SBC, Sprint, US West, and Western Wireless

**Dan Kostenbauder**, Tax Counsel  
Hewlett Packard Company

**Peter Lowy**, Co-President  
Westfield America, Inc.

**J. William McAuthur, Jr.**, Partner  
Knowledge Management Group  
and State Tax Consulting,  
PricewaterhouseCoopers, LLP

**Andrew Marsland**  
Sales Tax Division, Department of Finance, Canada

**Michael Mazerov**, Senior Policy Analyst  
Center on Budget and Policy Priorities

**Charles McLure, Ph.D.**, Senior Fellow  
Hoover Institution

**Peter R. Merrill**, Partner  
National Economic Consulting Group  
PricewaterhouseCoopers, LLP

**John Morabito**, Vice President  
Federal Legislative and Regulatory Affairs, Global  
Crossing, Ltd.

**Robert Novick**, General Counsel  
U.S. Trade Representative  
and Commissioner, Advisory Commission on  
Electronic Commerce

**Cindy Oakes**  
Tax Department  
Dell Computer Company

**Jon M. Peha, Ph.D.**, Professor  
Carnegie Mellon University

**Andrew Pincus**, General Counsel  
U.S. Dept. of Commerce  
and Commissioner, Advisory Commission on  
Electronic Commerce

**Steven J. Rauschenberger**, Illinois State Senator  
on behalf of the National Conference of State  
Legislatures

**Terrance P. Ryan**, Director  
State & Local Taxes Apple Computer, Inc.

**Ed Shimizu, Director**  
National Regulatory Relations, GTE Corporation

**John Sidgmore**, Vice Chairman  
MCI WorldCom, Chairman UUNET  
and Commissioner, Advisory Commission on  
Electronic Commerce

**Diann L. Smith**, General Counsel  
Committee on State Taxation

**Fred L. Smith**, President and Founder  
Competitive Enterprise Institute

**Frances B. Smith**, Executive Director  
Consumer Alert

**Stacey L. Sprinkle**, Assistant Vice President for Tax  
CommNet Cellular, Inc.

**Daniel L. Sullivan**, CEO  
Taxware International, Inc.

**Orson Swindle**, Commissioner  
Federal Trade Commission

**Adam Thierer**, Walker Fellow in Economic Policy  
The Heritage Foundation

**William Gregory Turner**,  
General Counsel and Legislative Director  
California Taxpayers Association

**Craig Winn**, Chairman  
Value America, Inc.

**Christopher Wysocki**, President  
Small Business Survival Committee

## ***Experts***

*(Invited by the Commission to attend meetings and  
be available to answer questions.)*

**Sonia Arrison**, Director  
Center for Freedom and Technology  
Pacific Research Institute

**Paul Bates**, Vice President  
Information Products Group  
Bizrate.com

**Mike Blandina**, CEO  
Esalestax.com

**Danielle Bujnak**, President  
Independence Forum

**Kaye Caldwell**, Public Policy Director  
CommerceNet

**Laurence J. DeFranco**  
InContext, Inc.

**Harley Duncan**, Executive Director  
Federation of Tax Administrators

**Jim Eads**, Partner  
Earnst & Young, LLP

**Wayne G. Eggert**, Senior Manager  
Lucent Technologies

**Jeffrey A. Eisenach Ph.D.**, President  
The Progress & Freedom Foundation

**Clifford A. Farmer**  
Sales Tax Clearinghouse

**Paul Francisco**  
TaxNet Systems, Inc.

**Peter H. Friedman**, CPA

**Peter Gray**  
Internet Consumers Association

**Brian Hanson**  
Hanson Bros. Fresh Seafood

**David E. Hardesty**, Vice President  
Markle Stuckey Hardesty & Bott

**Ed Harrington**, Comptroller  
City and County of San Francisco

**Walter Hellerstein, Ph.D.**, Professor  
University of Georgia

**Brian Horey**  
Tontine Associates, LLC

**Jim Johnson**  
EIKON Strategies, Inc.

**Alistair Kelman**, Director  
easyClear Limited

**Tilman L. Lay, Esq.**  
Miller, Canfield, Paddock and Stone, PLC

**David A. Lifson**, Chair  
Tax Executive Committee  
American Institute of Certified Public Accountants

**Aaron Lilly**,  
Technology and Communications Policy Analyst  
Citizens for a Sound Economy

*Witness List/Expert List*

**Aaron Lukas**, Analyst, Center for Trade Policy Studies  
Cato Institute

**Peter McGeough**  
Seaman Furniture Co., Inc.

**Thomas A. McGuire**  
Attorney at Law

**Eric Miethke, Esq.**  
Nielsen, Merksamer, Parrinello, Mueller & Naylor

**Mark Nebergall**  
Software Finance Executive Council

**William P. Olders**, President/CEO  
Data Kinetics

**David Polatseck**  
Data Processing Center

**Mark Rhoads**, Government Affairs Associate  
United States Internet Council

**Frank Shafroth**, Director  
Office of State-Federal Relations of the National  
Governors' Association

**Mark Stackpoole**, Vice President  
ATRACS Corporation

**Joseph F. Taricani Jr.**  
Interstate Solutions, LLC

**Orian Teicher**  
American Booksellers Association

**Bill Townsend**  
Holland & Knight, LLP

**William Gregory Turner**, General Counsel  
California Taxpayers Association

**Hal R. Varian**, Dean  
School of Information Management and Systems  
University of California, Berkeley

**Robert J. Verdisco**, President  
International Mass Retail Association

**Andrew Wagner**, Staff Director, Tax Law  
FDX Corporation

**William F. Willbrand**  
MPP&W Consultants

## Appendix E

# *Commissioners' Biographies*

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### **Dean F. Andal**

#### **Chairman, California Board of Equalization**

Dean F. Andal is chairman, second district, of the Board of Equalization for the state of California. Elected in 1994, Andal supports the Board's mission in serving the public through fair, effective, and efficient tax administration. Andal is also president of Andal Communications, a Stockton-based bank and real estate marketing company. Prior to joining the board, he was a two-term member of the California State Assembly as well as chief budget negotiator for Assembly Republicans. Andal was named 1992 Legislator of the Year by California's major taxpayer organizations.

### **C. Michael Armstrong**

#### **Chairman of the Board, AT&T**

C. Michael Armstrong is chairman of the board of AT&T. Armstrong currently serves as chairman of the President's Export Council and the FCC Network Reliability and Interoperability Council, and is a member of the Council on Foreign Relations, the National Security Telecommunications Advisory Committee, and the Defense Policy Advisory Committee on Trade. Prior to joining AT&T in 1997, he served five years as chairman and CEO of Hughes Electronics.

### **James S. Gilmore, III**

#### **Governor, Commonwealth of Virginia**

James S. Gilmore, III was elected Virginia's 68th Governor in November 1997. Having realized the need to foster a strong relationship between the state gov-

ernment and the technology community, Governor Gilmore quickly appointed a Secretary of Technology - the nation's first such cabinet-level technology post. Governor Gilmore also established the Governor's Commission on Information Technology, which drafted a comprehensive Internet policy for the state, another first in the nation. On March 30, 1999, Gilmore signed this sweeping Internet policy into law. Governor Gilmore serves on the Technology Committee of the National Governors' Association (NGA) and serves as a liaison between Republican Governors and the Congressional leadership. Previously, Gilmore served as Virginia's Attorney General, after serving two terms as the Commonwealth's Attorney for Henrico County.

### **Joseph H. Guttentag**

#### **Senior Advisor, Office of Tax Policy, U.S. Treasury Department**

#### **(Delegate for Lawrence H. Summers, Secretary of the Treasury)**

Joseph H. Guttentag is a senior advisor in the Office of Tax Policy and Advisory Commission delegate for Lawrence H. Summers. As such, he is responsible for advising the Assistant Secretary for Tax Policy and the Secretary with regard to various tax policy issues. Guttentag also serves as chairman of the Committee of Fiscal Affairs of the Organisation for Economic Cooperation and Development. Before serving as advisor, he was appointed to Deputy Assistant Secretary for International Tax Affairs. Prior to this appointment, Guttentag was a senior tax partner with the law firm of Arnold & Porter.

**Paul C. Harris, Sr.**  
**Delegate, Virginia House of Delegates**

Paul C. Harris, Sr., is a representative of the 58th District in the Virginia House of Delegates. Harris is also a partner in the law firm of Baise, Miller & Freer. He is active in many community and civic organizations, including the Virginia State Bar, the Charlottesville-Albermarle Chamber of Commerce, and The United Way. Prior to his election to the House of Delegates, Harris worked as a Dean's Fellow, teaching legal research and writing to first-year law students, followed by a two-year run with Virginia's largest law firm – McGuire, Woods, Battle & Boothe.

**Delna L. Jones**  
**County Commissioner, Washington County, Oregon**

Delna Jones is county commissioner for district two in the state of Oregon. Jones draws upon substantial experience in the private and public sector. Much of her district lies north and east of the cities of Beaverton and Hillsboro. Prior to this position, Jones spent nearly 30 years with US West Communications, holding various management positions, including director of Economic Development. From 1982 to 1994, Jones served in the Oregon House of Representatives. Jones has had an active role in state politics, including chair of the House Revenue and School Finance Committee. Jones served on other committees, including Education, Business and Consumer Affairs, Environment and Energy, and Trade and Economic Development.

**Ron Kirk**  
**Mayor, City of Dallas, Texas**

Ronald Kirk is mayor of the city of Dallas, Texas. Elected to the Mayor's office in 1995, Kirk is the first African American mayor of a major Texas city. He serves on the Advisory Board of the United States Conference of Mayors and chairs the Standing Committee on Urban Economic Policy for the United States Conference of Mayors. Prior to his election, Kirk was appointed as Texas' 98th Secretary of State. Kirk also worked as the City of Dallas' assistant city attorney and chief lobbyist, achieving a 90 percent success rate in passing the City's legislative agenda.

**Michael O. Leavitt**  
**Governor, State of Utah**

Michael O. Leavitt is governor of the state of Utah. Elected to the Governor's office in 1993, Leavitt has taken a leadership role in federal-state relations. In technology, he has launched a SmartStates initiative, which is focused on developing public-private partnerships to deliver state services through e-Commerce. Leavitt has shown leadership in attracting and nurturing high-technology companies and encouraging commerce in the private sector. Leavitt is the chairman of the National Governors' Association and also sits on the executive committee of the Republican Governors Association.

**Gene N. Lebrun**  
**President, National Conference of Commissioners on Uniform State Laws (1997-1999)**

Gene N. Lebrun is immediate past president of the National Conference of Commissioners on Uniform State Laws (NCCUSL). Since 1892, the NCCUSL has been involved in legislative reform activity, proposing and enacting uniform laws. NCCUSL representatives from each state — lawyers, judges, scholars, and government officials — propose and promulgate uniform and model acts. While President of NCCUSL he was a member of the House of Delegates of the American Bar Association. He was a member of the South Dakota legislature from 1971 through 1974, serving as Speaker of the House during the 1973 and 1974 sessions. Lebrun also serves as a Uniform Law Commissioner for South Dakota. Lebrun practices law with the Rapid City, South Dakota law firm of Lynn, Jackson, Shultz & Lebrun, P.C.

**Gary Locke**  
**Governor, State of Washington**

Gary Locke is the 21st governor of the state of Washington. Elected to the Governor's office in 1996, Locke is the first Chinese-American governor in U.S. history. He has undertaken major initiatives targeting the improvement of public schools, promotion of jobs and economic development in rural and urban areas, and fighting juvenile crime. In 1982, Locke was elected to the Washington State House of Representatives, where he served on the House Judiciary and Appropriations committees. Locke served his final five years there as chairman of the House Appropriations Committee.



**Grover G. Norquist**  
**President, Americans for Tax Reform**

Grover Norquist is president of Americans for Tax Reform (ATR), a coalition of taxpayer groups, individuals, and businesses opposed to higher taxes at both the federal and state levels. He also writes the monthly "Politics" column for the American Spectator. Prior to joining ATR, Norquist served as economist and chief speechwriter for the U.S. Chamber of Commerce. Norquist also served on the National Commission on Restructuring the Internal Revenue Service and was an executive director of the National Taxpayers' Union.

**Robert T. Novick**  
**General Counsel, Office of the United States Trade Representative**  
**(Delegate for Ambassador Charlene Barshefsky, United States Trade Representative)**

Robert Novick is general counsel in the Office of the United States Trade Representative (USTR) and Advisory Commission delegate for Ambassador Charlene Barshefsky. The Office of the General Counsel is responsible for legal issues related to United States trade policy and the negotiations of trade agreements. Previously, he served as counselor to the USTR, advising Ambassador Barshefsky on a broad range of policy and legal issues. Prior to joining the USTR, Novick was a partner with Steptoe & Johnson LLP in Washington, D.C., where he specialized in trade law and policy.

**Richard D. Parsons**  
**President, Time Warner Inc.**

Richard Parsons is president of Time Warner, Inc., a leading global media company. He is also a member of the Time Warner Board of Directors. Prior to joining Time Warner in 1994, Parsons served as chairman and CEO of Dime Bancorp, Inc., one of the largest thrift institutions in the United States with more than \$20 billion in assets. Parsons also served as a managing partner of the New York law firm of Patterson, Belknap, Webb, and Tyler.

**Andrew J. Pincus**  
**General Counsel, U.S. Department of Commerce**  
**(Delegate for William M. Daley, Secretary of Commerce)**

Andrew Pincus is general counsel for the U.S. Department of Commerce and Advisory Commission

delegate for William Daley. Nominated by President Clinton and confirmed by the United States Senate in 1997, Pincus is the chief legal advisor for the Department. He also serves as a senior policy advisor for the Secretary and the Department on a broad range of domestic and international issues. Prior to joining the Department of Commerce, he was a partner at the law firm of Mayer, Brown & Platt. Pincus also served as assistant to the Solicitor General at the U.S. Department of Justice.

**Robert W. Pittman**  
**President & Chief Operating Officer, America Online, Inc.**

Robert Pittman is president and chief operating officer of America Online, Inc. and a member of its Board of Directors. Mr. Pittman oversees the overall day-to-day operations of the world's leader in branded interactive services. Prior to joining America Online, Mr. Pittman served as chief executive officer of Century 21 Real Estate, Six Flags Entertainment, Time Warner Enterprises, Quantum Media and MTV Networks.

**David S. Pottruck**  
**President & co-Chief Executive Officer, Charles Schwab Corporation**

David Pottruck is president and co-chief executive officer of Charles Schwab Corporation, as well as a member of its Board of Directors. The Charles Schwab Corporation, through its principal operating subsidiary Charles Schwab & Company, Inc., is one of the nation's largest financial services firms, serving 4.7 million active investor accounts. Pottruck directs the Company's financial, technology, and administrative groups. During his tenure as president, the Company's revenues have increased nearly threefold. Pottruck joined the firm in 1984 from Shearson/American Express.

**John W. Sidgmore**  
**Vice Chairman, MCI WorldCom and Chairman, UUNET Technologies**

John W. Sidgmore is vice chairman of MCI WorldCom and chairman of UUNET. He joined the company in 1994 as president and chief executive officer. Sidgmore is responsible for MCI WorldCom's technology vision and Internet services. Prior to joining MCI WorldCom, Sidgmore was president and CEO of CSC Intelicom (formerly Intelicom Solutions). Before joining

CSC, he spent 14 years with General Electric Information Services (GEISCO). During his four-year tenure as vice president and general manager, Sidgmore engineered a turnaround in GEIS' U.S. performance, which led to a tripling of net income and a 20 percent growth in revenue.

**Stanley S. Sokul**

**Independent Consultant, Association for Interactive Media**

Stanley Sokul is an independent consultant to the Association for Interactive Media (AIM) on Internet taxation and is an experienced congressional advisor with extensive knowledge of a variety of Internet and taxation issues. Sokul previously served as the top D.C. aide to Senator Judd Gregg (R-NH). In this position, he helped draft Senator Gregg's Net FAIR Internet tax moratorium bill, many of which key provisions were incorporated into the final version of the Internet Tax

Freedom Act. Sokul is currently a public policy consultant at Davidson & Company in Washington, D.C.

**Theodore W. Waitt**

**Chairman, Gateway, Inc.**

Theodore Waitt is chairman of Gateway, Inc., a multi-national, Fortune 500 company with more than 19,000 employees and 1998 sales of \$7.5 billion. Since co-founding Gateway 13 years ago, Waitt has helped transform the direct sales model in the computer business into a major, shaping force for the entire industry. Over the years, Waitt has earned a number of prestigious honors, including: the Young Entrepreneur of the Year award from the U.S. Small Business Association, an honorary doctorate of science degree from the University of South Dakota, and the Ten Outstanding Young Americans (TOYA) award from the United States Junior Chamber of Commerce.

## Appendix F

# *Enabling Statute: Internet Tax Freedom Act*

*Public Law 105-277, October 21, 1998*

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### **SEC. 1101. MORATORIUM.**

(a) MORATORIUM.—No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending 3 years after the date of the enactment of this Act—

(1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998; and

(2) multiple or discriminatory taxes on electronic commerce.

(b) PRESERVATION OF STATE AND LOCAL TAXING AUTHORITY.—

Except as provided in this section, nothing in this title shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act.

(c) LIABILITIES AND PENDING CASES.—Nothing in this title affects liability for taxes accrued and enforced before the date of enactment of this Act, nor does this title affect ongoing litigation relating to such taxes.

(d) DEFINITION OF GENERALLY IMPOSED AND ACTUALLY ENFORCED.—For purposes of this sec-

tion, a tax has been generally imposed and actually enforced prior to October 1, 1998, if, before that date, the tax was authorized by statute and either—

(1) a provider of Internet access services had a reasonable opportunity to know by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services; or

(2) a State or political subdivision thereof generally collected such tax on charges for Internet access.

(e) EXCEPTION TO MORATORIUM.—

(1) IN GENERAL.—Subsection (a) shall also not apply in the case of any person or entity who knowingly and with knowledge of the character of the material, in interstate or foreign commerce by means of the World Wide Web, makes any communication for commercial purposes that is available to any minor and that includes any material that is harmful to minors unless such person or entity has restricted access by minors to material that is harmful to minors—

(A) by requiring use of a credit card, debit account, adult access code, or adult personal identification number;

(B) by accepting a digital certificate that verifies age; or

(C) by any other reasonable measures that are feasible under available technology.

(2) SCOPE OF EXCEPTION.—For purposes of paragraph (1), a person shall not be considered to making a communication for commercial purposes of material to the extent that the person is—

(A) a telecommunications carrier engaged in the provision of telecommunications service;

(B) a person engaged in the business of providing an Internet access service;

(C) a person engaged in the business of providing an Internet information location tool; or

(D) similarly engaged in the transmission, storage, retrieval, hosting, formatting, or translation (or any combination thereof) of a communication made by another person, without selection or alteration of the communication.

(3) DEFINITIONS.—In this subsection:

(A) BY MEANS OF THE WORLD WIDE WEB.—The term “by means of the World Wide Web” means by placement of material in a computer server-based file archive so that it is publicly accessible, over the Internet, using hypertext transfer protocol, file transfer protocol, or other similar protocols.

(B) COMMERCIAL PURPOSES; ENGAGED IN THE BUSINESS.—

(i) COMMERCIAL PURPOSES.—A person shall be considered to make a communication for commercial purposes only if such person is engaged in the business of making such communications.

(ii) ENGAGED IN THE BUSINESS.—The term “engaged in the business” means that the person who makes a communication, or offers to make a communication, by means of the World Wide Web, that includes any material that is harmful to minors, devotes time, attention, or labor to such activities, as a regular course of such person’s trade or business, with the objective of earning a profit as a result of such activities (although it is not necessary that the person make a profit or that the making or offering to make such communications be the person’s sole or principal business or source of income). A person may be considered to be engaged in the business of making, by means of the World Wide Web, communications for commercial purposes that include material that is harmful to minors, only if the person knowingly

causes the material that is harmful to minors to be posted on the World Wide Web or knowingly solicits such material to be posted on the World Wide Web.

(C) INTERNET.—The term “Internet” means collectively the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected worldwide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio.

(D) INTERNET ACCESS SERVICE.—The term “Internet access service” 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 consumers. Such term does not include telecommunications services.

(E) INTERNET INFORMATION LOCATION TOOL.—The term “Internet information location tool” means a service that refers or links users to an online location on the World Wide Web. Such term includes directories, indices, references, pointers, and hypertext links.

(F) MATERIAL THAT IS HARMFUL TO MINORS.—The term “material that is harmful to minors” means any communication, picture, image, graphic image file, article, recording, writing, or other matter of any kind that is obscene or that—

(i) the average person, applying contemporary community standards, would find, taking the material as a whole and with respect to minors, is designed to appeal to, or is designed to pander to, the prurient interest;

(ii) depicts, describes, or represents, in a manner patently offensive with respect to minors, an actual or simulated sexual act or sexual contact, an actual or simulated normal or perverted sexual act, or a lewd exhibition of the genitals or post-pubescent female breast; and

(iii) taken as a whole, lacks serious literary, artistic, political, or scientific value for minors.

(G) MINOR.—The term “minor” means any person under 17 years of age.

(H) TELECOMMUNICATIONS CARRIER; TELECOMMUNICATIONS SERVICE.—The terms “telecommunications carrier” and “telecommunications service”

have the meanings given such terms in section 3 of the Communications Act of 1934 (47 U.S.C. 153).

(f) ADDITIONAL EXCEPTION TO MORATORIUM.—

(1) IN GENERAL.—Subsection (a) shall also not apply with respect to an Internet access provider, unless, at the time of entering into an agreement with a customer for the provision of Internet access services, such provider offers such customer (either for a fee or at no charge) screening software that is designed to permit the customer to limit access to material on the Internet that is harmful to minors.

(2) DEFINITIONS.—In this subsection:

(A) INTERNET ACCESS PROVIDER.—The term ‘Internet access provider’ means a person engaged in the business of providing a computer and communications facility through which a customer may obtain access to the Internet, but does not include a common carrier to the extent that it provides only telecommunications services.

(B) INTERNET ACCESS SERVICES.—The term ‘Internet access services’ means the provision of computer and communications services through which a customer using a computer and a modem or other communications device may obtain access to the Internet, but does not include telecommunications services provided by a common carrier.

(C) SCREENING SOFTWARE.—The term “screening software” means software that is designed to permit a person to limit access to material on the Internet that is harmful to minors.

(3) APPLICABILITY.—Paragraph (1) shall apply to agreements for the provision of Internet access services entered into on or after the date that is 6 months after the date of enactment of this Act.

## **SEC. 1102. ADVISORY COMMISSION ON ELECTRONIC COMMERCE.**

(a) ESTABLISHMENT OF COMMISSION.—There is established a commission to be known as the Advisory Commission on Electronic Commerce (in this title referred to as the “Commission”). The Commission shall—

(1) be composed of 19 members appointed in accordance with subsection (b), including the chairperson who shall be selected by the members of the Commission from among themselves; and

(2) conduct its business in accordance with

the provisions of this title.

(b) MEMBERSHIP.—

(1) IN GENERAL.—The Commissioners shall serve for the life of the Commission. The membership of the Commission shall be as follows:

(A) 3 representatives from the Federal Government, comprised of the Secretary of Commerce, the Secretary of the Treasury, and the United States Trade Representative (or their respective delegates).

(B) 8 representatives from State and local governments (one such representative shall be from a State or local government that does not impose a sales tax and one representative shall be from a State that does not impose an income tax).

(C) 8 representatives of the electronic commerce industry (including small business), telecommunications carriers, local retail businesses, and consumer groups, comprised of—

(i) 5 individuals appointed by the Majority Leader of the Senate;

(ii) 3 individuals appointed by the Minority Leader of the Senate;

(iii) 5 individuals appointed by the Speaker of the House of Representatives; and

(iv) 3 individuals appointed by the Minority Leader of the House of Representatives.

(2) APPOINTMENTS.—Appointments to the Commission shall be made not later than 45 days after the date of the enactment of this Act. The chairperson shall be selected not later than 60 days after the date of the enactment of this Act.

(3) VACANCIES.—Any vacancy in the Commission shall not affect its powers, but shall be filled in the same manner as the original appointment.

(c) ACCEPTANCE OF GIFTS AND GRANTS.—The Commission may accept, use, and dispose of gifts or grants of services or property, both real and personal, for purposes of aiding or facilitating the work of the Commission. Gifts or grants not used at the expiration of the Commission shall be returned to the donor or grantor.

(d) OTHER RESOURCES.—The Commission shall have reasonable access to materials, resources, data, and other information from the Department of Justice,

the Department of Commerce, the Department of State, the Department of the Treasury, and the Office of the United States Trade Representative. The Commission shall also have reasonable access to use the facilities of any such Department or Office for purposes of conducting meetings.

(e) SUNSET.—The Commission shall terminate 18 months after the date of the enactment of this Act.

(f) RULES OF THE COMMISSION.—

(1) QUORUM.—Nine members of the Commission shall constitute a quorum for conducting the business of the Commission.

(2) MEETINGS.—Any meetings held by the Commission shall be duly noticed at least 14 days in advance and shall be open to the public.

(3) OPPORTUNITIES TO TESTIFY.—The Commission shall provide opportunities for representatives of the general public, taxpayer groups, consumer groups, and State and local government officials to testify.

(4) ADDITIONAL RULES.—The Commission may adopt other rules as needed.

(g) DUTIES OF THE COMMISSION.—

(1) IN GENERAL.—The Commission shall conduct a thorough study of Federal, State and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities.

(2) ISSUES TO BE STUDIED.—The Commission may include in the study under subsection (a)—

(A) an examination of—

(i) barriers imposed in foreign markets on United States providers of property, goods, services, or information engaged in electronic commerce and on United States providers of telecommunications services; and

(ii) how the imposition of such barriers will affect United States consumers, the competitiveness of United States citizens providing property, goods, services, or information in foreign markets, and the growth and maturing of the Internet;

(B) an examination of the collection and administration of consumption taxes on electronic commerce in other countries and the United States, and the impact of such collection on the global economy, including an examination of the relationship between the

collection and administration of such taxes when the transaction uses the Internet and when it does not;

(C) an examination of the impact of the Internet and Internet access (particularly voice transmission) on the revenue base for taxes imposed under section 4251 of the Internal Revenue Code of 1986;

(D) an examination of model State legislation that—

(i) would provide uniform definitions of categories of property, goods, service, or information subject to or exempt from sales and use taxes; and

(ii) would ensure that Internet access services, online services, and communications and transactions using the Internet, Internet access service, or online services would be treated in a tax and technologically neutral manner relative to other forms of remote sales;

(E) an examination of the effects of taxation, including the absence of taxation, on all interstate sales transactions, including transactions using the Internet, on retail businesses and on State and local governments, which examination may include a review of the efforts of State and local governments to collect sales and use taxes owed on in-State purchases from out-of-State sellers; and

(F) the examination of ways to simplify Federal and State and local taxes imposed on the provision of telecommunications services.

(3) EFFECT ON THE COMMUNICATIONS ACT OF 1934.—Nothing in this section shall include an examination of any fees or charges imposed by the Federal Communications Commission or States related to—

(A) obligations under the Communications Act of 1934 (47 U.S.C. 151 et seq.); or

(B) the implementation of the Telecommunications Act of 1996 (or of amendments made by that Act).

(h) NATIONAL TAX ASSOCIATION COMMUNICATIONS AND ELECTRONIC COMMERCE TAX PROJECT.—The Commission shall, to the extent possible, ensure that its work does not undermine the efforts of the National Tax Association Communications and Electronic Commerce Tax Project.

**SEC. 1103. REPORT.**

Not later than 18 months after the date of the enactment of this Act, the Commission shall transmit to Congress for its consideration a report reflecting the results, including such legislative recommendations as required to address the findings of the Commission's study under this title. Any recommendation agreed to by the Commission shall be tax and technologically neutral and apply to all forms of remote commerce. No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission serving at the time the finding or recommendation is made.

**SEC. 1104. DEFINITIONS.**

For the purposes of this title:

(1) BIT TAX.—The term “bit tax” means any tax on electronic commerce expressly imposed on or measured by the volume of digital information transmitted electronically, or the volume of digital information per unit of time transmitted electronically, but does not include taxes imposed on the provision of telecommunications services.

(2) DISCRIMINATORY TAX.—The term “discriminatory tax” means—

(A) any tax imposed by a State or political subdivision thereof on electronic commerce that—

(i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;

(ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;

(iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means;

(iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means; or

(B) any tax imposed by a State or political subdivision thereof, if—

(i) except with respect to a tax (on Internet access) that was generally imposed and actually enforced prior to October 1, 1998, the sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation; or

(ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of—

(I) 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; or

(II) the processing of orders through the out-of-State computer server of a provider of Internet access service or online services.

(3) ELECTRONIC COMMERCE.—The term “electronic commerce” means any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access.

(4) INTERNET.—The term “Internet” means collectively the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio.

(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.

(6) MULTIPLE TAX.—

(A) IN GENERAL.—The term “multiple tax” means any tax that is imposed by one State or political subdivision thereof on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions.

(B) EXCEPTION.—Such term shall not include a sales or use tax imposed by a State and 1 or more political subdivisions thereof on the same electronic commerce or a tax on persons engaged in electronic commerce which also may have been subject to a sales or use tax thereon.

(C) SALES OR USE TAX.—For purposes of subparagraph (B), the term “sales or use tax” means a tax that is imposed on or incident to the sale, purchase, storage, consumption, distribution, or other use of tangible personal property or services as may be defined by laws imposing such tax and which is measured by the amount of the sales price or other charge for such property or service.

(7) STATE.—The term “State” means any of the several States, the District of Columbia, or any commonwealth, territory, or possession of the United States.

(8) TAX.—

(A) IN GENERAL.—The term “tax” means—

(i) any charge imposed by any governmental entity for the purpose of generating revenues for governmental purposes, and is not a fee imposed for a specific privilege, service, or benefit conferred; or

(ii) the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity.

(B) EXCEPTION.—Such term does not include any franchise fee or similar fee imposed by a State or local franchising authority, pursuant to section 622 or 653 of the Communications Act of 1934 (47 U.S.C. 542, 573), or any other fee related to obligations or telecommunications carriers under the Communications Act of 1934 (47 U.S.C. 151 et seq.).

(9) TELECOMMUNICATIONS SERVICE.—The term “telecommunications service” has the meaning given such term in section 3(46) of the Communications Act of 1934 (47 U.S.C. 153(46)) and includes communications services (as defined in section 4251 of the Internal Revenue Code of 1986).

(10) TAX ON INTERNET ACCESS.—The term “tax on Internet access” means a tax on Internet access, including the enforcement or application of any new or preexisting tax on the sale or use of Internet services unless such tax was generally imposed and actually enforced prior to October 1, 1998.

TITLE XII—OTHER PROVISIONS

**SEC. 1201. DECLARATION THAT INTERNET SHOULD BE FREE OF NEW FEDERAL TAXES.**

It is the sense of Congress that no new Federal taxes similar to the taxes described in section 1101(a) should be enacted with respect to the Internet and Internet access during the moratorium provided in such section.

**SEC. 1202. NATIONAL TRADE ESTIMATE.**

Section 181 of the Trade Act of 1974 (19 U.S.C. 2241) is amended—

(1) in subsection (a)(1)—

(A) in subparagraph (A)—

(i) by striking “and” at the end of clause (i);

(ii) by inserting “and” at the end of clause (ii); and

(iii) by inserting after clause (ii) the following new clause:

“(iii) United States electronic commerce;” and



- (B) in subparagraph (C)—
- (i) by striking “and” at the end of clause (i);
  - (ii) by inserting “and” at the end of clause (ii);
  - (iii) by inserting after clause (ii) the following new clause:

“(iii) the value of additional United States electronic commerce;” and

(iv) by inserting “or transacted with,” after “or invested in”;

- (2) in subsection (a)(2)(E)—

(A) by striking “and” at the end of clause (i);

- (B) by inserting “and” at the end of clause (ii); and

(C) by inserting after clause (ii) the following new clause:

“(iii) the value of electronic commerce transacted with;” and

- (3) by adding at the end the following new subsection:

“(d) ELECTRONIC COMMERCE.—For purposes of this section, the term ‘electronic commerce’ has the meaning given that term in section 1104(3) of the Internet Tax Freedom Act.”

### **SEC. 1203. DECLARATION THAT THE INTERNET SHOULD BE FREE OF FOREIGN TARIFFS, TRADE BARRIERS, AND OTHER RESTRICTIONS.**

(a) IN GENERAL.—It is the sense of Congress that the President should seek bilateral, regional, and multilateral agreements to remove barriers to global electronic commerce through the World Trade Organization, the Organization for Economic Cooperation and Development, the Trans-Atlantic Economic Partnership, the Asia Pacific Economic Cooperation forum, the Free Trade Area of the America, the North American Free Trade Agreement, and other appropriate venues.

(b) NEGOTIATING OBJECTIVES.—The negotiating objectives of the United States shall be—

- (1) to assure that electronic commerce is free from—

- (A) tariff and nontariff barriers;
- (B) burdensome and discriminatory regulation and standards; and
- (C) discriminatory taxation; and

(2) to accelerate the growth of electronic commerce by expanding market access opportunities for—

(A) the development of telecommunications infrastructure;

(B) the procurement of telecommunications equipment;

(C) the provision of Internet access and telecommunications services; and

(D) the exchange of goods, services, and digitalized information.

(c) ELECTRONIC COMMERCE.—For purposes of this section, the term “electronic commerce” has the meaning given that term in section 1104(3).

### **SEC. 1204. NO EXPANSION OF TAX AUTHORITY.**

Nothing in this title shall be construed to expand the duty of any person to collect or pay taxes beyond that which existed immediately before the date of the enactment of this Act.

### **SEC. 1205. PRESERVATION OF AUTHORITY.**

Nothing in this title shall limit or otherwise affect the implementation of the Telecommunications Act of 1996 (Public Law 104–104) or the amendments made by such Act.

### **SEC. 1206. SEVERABILITY.**

If any provision of this title, or any amendment made by this title, or the application of that provision to any person or circumstance, is held by a court of competent jurisdiction to violate any provision of the Constitution of the United States, then the other provisions of that title, and the application of that provision to other persons and circumstances, shall not be affected.



## Appendix G

# *Opinion of Legal Counsel*

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To view the statement by the Commission's Counsel, Thomas B. Griffith, Esq., and letters that support it from Speaker of the House of Representatives Dennis Hastert and Senate Majority Leader Trent Lott, click on the link below:

<http://www.ecommercecommission.org/counsel.pdf>



*Advisory Commission on Electronic Commerce*

[www.ecommercecommission.org](http://www.ecommercecommission.org)