

**THE REPORT OF THE ADVISORY COMMISSION
ON ELECTRONIC COMMERCE**

HEARING
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS,
TRADE, AND CONSUMER PROTECTION
OF THE
COMMITTEE ON COMMERCE
HOUSE OF REPRESENTATIVES

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THE REPORT OF THE ADVISORY COMMISSION ON ELECTRONIC COMMERCE

THURSDAY, APRIL 6, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS,
TRADE, AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2123, Rayburn House Office Building, the Hon. W.J. "Billy" Tauzin, (chairman) presiding.

Members present: Representatives Tauzin, Oxley, Stearns, Gilmore, Cox, Cubin, Shimkus, Wilson, Pickering, Fossella, Ehrlich, Bliley (ex officio), Markey, Eshoo, Wynn, Luther, Sawyer, Green, and McCarthy.

Also present: Representative Upton.

Staff present: Justin Lilley, majority counsel; Cliff Riccio, legislative clerk; and Andy Levin, minority counsel.

Mr. TAUZIN. The committee will please come to order. Let me ask all our guests to take seats, and we want to accommodate Governor Gilmore in a timely fashion, so we will begin this hearing as we wait for other members to join us, Governor.

The subcommittee today has a very high honor of welcoming the Governor of Virginia to the Committee on Commerce. Governor Gilmore serves as the Chairman of the Advisory Commission on electronic commerce, and he's here today to summarize for us the commission's work, which is recently completed.

Let us first begin by congratulating Governor on his fine work. Congress has obviously assigned a rather daunting task to the commission. You and the majority of your colleagues, in our opinion, have performed it admirably. You pulled together a wealth of information and proposals that will surely guide this committee and the Congress as it moves forward with legislation to codify the work of the commission.

I think we can agree that E commerce holds rich potential, that we almost think very carefully about whether we want to or need to extend the hand of the tax man into the web. I, along with the majority leader, Dicker Armey, have toured this Nation to hear from the American people on the issue of taxes. We have done 40 different cities in America in our Scrap the Code Tour, Governor. If there's one thing we've learned from those tours, it's that the American people think we're not listening to them yet. The politicians are indifferent to the fact that over half of what they earn goes to some level of government today.

We must, therefore, make it clear to consumers that on this one important issue on the Internet, we're going to be listening very carefully, and we're going to be watching out for their interest. After all, we owe it to them. Let me remind my colleagues that the tax man can take many forms, including the FCC. That's why I and 132 of my colleagues have co-sponsored legislation introduced by Congressman Upton that would bar the FCC from imposing permanent access charges on Internet access services.

I urge my colleagues to use today's hearing to begin thinking about what this report means for the future of taxation at every level of government. We're a country of limited government, based on the principle that government will take only that which it truly needs for the people of our country. Governor Gilmore will today help us understand what he and his colleagues learned about the government's needs when it comes to the issue of E commerce. I certainly welcome him and congratulate him on his fine work, and look forward to working with him to enact the proposals of the commission.

The Chair will now welcome other members for opening statements before I introduce the chairman of the full Committee on Commerce, who will have the honor and privilege of introducing the Governor of his home State of Virginia in just a second. Now the Chair recognizes the ranking minority member, Mr. Markey, for an opening statement.

Mr. MARKEY. Thank you, Mr. Chairman, very much. I want to commend you for calling this hearing today to hear from Governor Gilmore on his perspective on the work of the special commission we established to explore issues relating to Internet taxation.

I approach the issue of Internet taxation as someone who supported the Internet Tax Freedom Act. We made a wise decision to say time out and to give a blue ribbon panel with representatives of the States, cities, industry, and the Federal Government an opportunity to create a consensus on how to handle this issue. I think that the Internet Tax Freedom Act had a laudable goal, to protect electronic commerce in its infancy from excessive, discriminatory, or confusing taxation.

It is important to keep things in perspective. The magnitude of what we're talking about is relatively small. The Department of Commerce announced just a month ago that the estimate of U.S. retail E commerce sales for the fourth quarter of 1999, October through December, was \$5.3 billion. That means that E commerce sales accounted for less than 1 percent of the total retail sales estimates, which was \$821.2 billion for that quarter, yet there is little question that the growth curve for online commerce promises to be exponential in nature.

There are a number of key questions that I believe need to be asked before we consider making the Internet completely tax free or making the current moratoria prohibitions last into perpetuity. For example, is treating online retailers more favorably from a tax standpoint than old time storefront retailers necessary for online commerce to succeed and flourish? Can the Internet survive an online tax onslaught from thousands of taxing jurisdictions? If you believe the answer to that question is no, then do you favor making a tax ban permanent, or do you favor simplifying the tax collection

amongst jurisdictions in order to reflect the reach of the new technology?

Recognizing the reality of the current digital divide, will we exacerbate that gap with a cybertax policy that favors the wealthy, who are more likely to shop online, over the poor, who lacking access, will continue to pay taxes for purchases in stores. For those who are against Internet taxes, what taxes do you favor? Income taxes? Inheritance taxes? Property taxes? Some taxes will have to be raised if we're going to take these taxes off of the books. I think there's a responsibility to have a concomitant discussion of the taxes that are going to be raised with the same discussion of which taxes are going to be lowered or eliminated. They're not two separate conversations. It's all part of the same discussion.

The Internet tax moratorium has helped to focus everyone's attention, and for that reason I believe it has been very helpful, not only because it has been educational from a technology standpoint for many people, but because it assists us in re-examining our tax policies generally. I believe that it is wise that the moratorium to be guided by the principle that we don't want to single out the Internet for discriminatory tax treatment.

In other words, I believe that the current moratorium has been useful to the extent that it has prevented taxing entities from singling out and victimizing Internet companies in a discriminatory way for tax treatment. Just as many Members of Congress, like myself, voted to prevent a rushed tax. I believe simultaneously that we ought not to rush to make a tax prohibition permanent. We ought to tread very carefully in this area before we unwittingly create a cyberspace Cayman Islands, like a tax haven without intending such a result.

Finally, I think that we should note the irony that we are hearing from Governor Gilmore immediately preceding a hearing on legislation introduced by Congressman Pickering, myself, Mrs. Wilson, Mr. Largent, Jim Tauzin, and ranking member Mr. Dingell, that streamline the process for collecting and assessing tax revenue on mobile telephones. Increasingly, consumers take their phones from State to State, city to city. Right now, because of the mobile nature of cellular phone use and the often unclear obligations and methodologies for collecting tax revenue from wireless service and different taxing jurisdictions, the cellular industry is burdened administratively. Consumers are often confused about billing, and tax officers from coast to coast are left trying to explain nexus issues.

The cellular industry, worked in concert with our Nation's Governors and tax commissioners to come up with a commendable, straightforward plan to assess uniformly the taxes at a cellular consumer's place of primary use. This is a laudable effort, and one which I am pleased to co-sponsor with Congressman Pickering.

I think it can serve as a model for building consensus on issues affecting interstate commerce and State and local tax jurisdictions. Again, I want to commend the chairman for scheduling this double header today, as the baseball season opens. I think we have two great hearings, and I think him for his courtesy in allowing me a couple of extra minutes to finish my opening statement.

Mr. TAUZIN. The Chair would ask unanimous consent that we waive giving any further opening statements in order to accommo-

date the schedule of the Governor. If both sides will agree, I can then introduce the chairman of the Commerce Committee and introduce the Governor. Let me explain. The Governor just informed me this morning—I want to sympathize with you a bit, Governor, the legislature just left town in Virginia and left him with 1100 bills that he's got to read and either sign a veto by Sunday. I think we need to accommodate him if we can. Can I have any signal as to whether or not unanimous consent of that nature would be acceptable?

Ms. ESHOO. I don't want to spend more time debating it. How many of us are here and how many minutes would it be? Five minutes, 6 minutes? These are really important issues.

Mr. TAUZIN. Well, then, the Chair will not put the unanimous consent if the gentlelady has a problem. Is there anyone on this side that wishes to make an opening statement? Then the gentlelady is recognized.

Ms. ESHOO. Thank you, Mr. Chairman. I'll move as quickly as possible. Good morning to you and welcome to Governor Gilmore. Today we're participating in two hearings. In each, we're going to learn about a group of government entities and business interests and their effort to reform tax laws that threaten the development of technologies important to our Nation's economic success. One group, I believe, has done better than the other.

In the hearing on wireless communications, we're going to hear from four individuals, each representing different interests, who appear to have succeeded in reforming a complicated and conflicting tax structure now hampering the growth of wireless communication. We have a document, a bill, we on the committee can refer to.

In this hearing, I don't believe we are as fortunate. First, contrary to committee materials provided to us, as well as several press reports, this committee is not receiving the report of the advisory committee on electronic commerce today. There is not a report. It hasn't been written, but apparently a draft exists.

Second, while I, of course, welcome the chairman of the commission, Governor Gilmore, to our committee, I believe we are receiving his report of a summary of recommendations. These recommendations were passed by a majority of the commission, which is less than the Congressionally mandated super majority. In reviewing the written testimony submitted by the witness, much of the statement offers his personal opinion about the work product of the commission. My preference would have been to hear the opinions of other commission members.

The advisory commission faced difficult challenges. The issue of taxes and E commerce are complicated and quickly lead to fundamental questions about the basic commercial tax structure of our Nation, and whether a revolutionary overhaul is needed on State and local taxes and how they are collected. I agree with several of the so-called recommendations we will hear today, but I am disappointed that the committee is hearing a summary of a draft report not yet fully written and which is being presented by the witness today representing a commission so divided that it could not meet the criteria that Congress established for its recommendations.

I compliment the hard work the Governor and the rest of the Commission put into the effort. I suspect many of the commission members, especially those from the private sector, got a real life lesson in public policymaking and how difficult it is to find consensus on a fair and workable tax structure. As a member of this Commerce Committee, I hope we are able to have a more comprehensive hearing in the future, and I hope you will conduct that, Mr. Chairman, one with the Commission's actual report and one where we can perhaps have several of the Commission members before us. It would be instructive to hear them recount some of the problems they encountered and discuss their views on why they think the Commission could not meet the requirements set by Congress.

The Advisory Commission, I think we all agree, worked very hard, and they wrestled with issues this committee will face in the future. I think we owe it to ourselves, as well as to our constituents and to our country, to get a fuller and better picture of what occurred.

Thank you, Mr. Chairman, and I look forward to hearing from Governor Gilmore.

Mr. TAUZIN. I thank the gentlelady. The Chair and the committee is very grateful that the Chairman of the Commission has consented to come and give us his early report and summarize the majority of the recommendations of the Commission, even those that did not attain the two-thirds super majority specified in our legislation, and to recognize and present the Governor to the committee, the Chair is now pleased to recognize the gentleman from Richmond, Virginia, the chairman of the full Commerce Committee, Mr. Bliley, for an introduction.

Chairman BLILEY. Thank you, Mr. Chairman, and thank you for holding this timely and important hearing. Let me just begin by extending a very warm welcome to my good friend, the Governor of Virginia, Jim Gilmore. It's an honor to have you here, Governor, and you know and I know I've had the pleasure of working with you from your days as a Commonwealth attorney of Henrico County and when you were attorney general and now, of course, as you are the Chief Executive Officer of Virginia.

This subcommittee has important business to attend to today, and the subject is Internet taxes. There's an old saying that there's nothing more certain in life than death and taxes, and as a former funeral home director and a Member of Congress for the last 20 years, I have some familiarity with both subjects.

Today we will hear from Governor Gilmore about the work of the Advisory Commission on electronic commerce. The committee crafted the Internet Tax Freedom Act and the Advisory Commission, and it is only fitting that this committee be the first to hear the Chairman's report.

Let me say that I hardly endorse the majority proposals that the Governor will outline for us this morning. This committee has developed a record on important E commerce issues, and if there's one recurring theme in that record, it is that taxation and regulation could kill the goose that lays the golden egg. I know that some claim that tax revenues will erode unless States and localities have the ability to tax online retailers, but I have yet to see evidence

that conclusively shows that E commerce threatens State and local tax revenue. Quite the opposite. All the evidence points in the opposite direction. If States and localities are permitted to tax E commerce and the Internet access, consumer demand will wither.

Now, understand that some, including the Clinton-Gore administration, have complained about our lack of a super majority consensus on the Commission, but it's hard to sympathize with those who complain when they refuse to support common sense proposals. I suspect that what's really going on here is a hidden agenda, an agenda to tax the Internet. This pro-tax faction is now hiding behind alleged process concerns as a reason to abstain from voting on proposals that keep the tax men out of cyberspace. If that's political leadership, then I invented the Internet.

There's no process concerns here. A majority of the Commission has provided this committee and Congress with strong and sound proposals that will insure a robust, electronic marketplace well into the future. I look forward to enacting as many of those proposals as possible. This committee will do its share of pushing this important anti-tax agenda along. Consumers expect tax relief from this commerce. They should get it.

In closing, let me say that I regard the Internet Tax Freedom Act as one of the most important accomplishments from the 105th Congress. I am hopeful that Congress will soon be able to build on that act. Then we will be able to look back on the 106th Congress with the same sense of pride and achievement.

Governor Gilmore, welcome to the Commerce Committee, and congratulations for a job well done. Mr. Chairman, I yield back the balance of my time.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. MICHAEL G. OXLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Mr. Chairman, and thanks to Governor Gilmore for joining us today to present the Commission's summary.

Internet technology continues to revolutionize the American way of life in every facet, from real-time stock trading and travel reservations to online computer games. The Internet has exploded in just a few years to become the most creative technological medium in history. It is allowing people in rural areas, such as Ohio's Fourth Congressional District, to gain easy access to information and services, making them less economically remote.

In fact, many of my constituents are able to access the Internet for free, either in their local public libraries or by utilizing one of many no-fee Internet service providers. There is no doubt that these free options have attracted many thousands of people to the online community who would not otherwise have had access.

The absence of government regulation of the Internet has contributed dramatically to its expansion. I think we should be careful not to over-regulate the online world and risk stifling its continued growth. I was proud to support the Internet Tax Freedom Act in the last Congress, which established the three-year moratorium on the imposition of Internet-related taxes.

We are now more than halfway through that three-year period, during which the Advisory Commission on Electronic Commerce has worked diligently to study the potential effects of access charges and taxation on e-commerce. I salute Governor Gilmore and the other members of the Commission for their thousands of hours of service to this task. I look forward to your testimony today, Governor, and look forward to receiving the Commission's full report later this month.

Thank you, Mr. Chairman. I yield back the balance of my time.

PREPARED STATEMENT OF HON. CLIFF STEARNS, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF FLORIDA

Mr. Speaker, I thank you for holding this hearing for the Chairman of the Advisory Commission on Electronic Commerce to provide the Subcommittee with a summary of the Commission's report to Congress. I give special thanks to Governor Gilmore and all of his efforts as Chairman of the Advisory Commission on Electronic Commerce.

We are all now familiar with the immense growth and presence of the Internet. Electronic commerce is now one of the leading drivers of the U.S. economy. It accounts for 2.3 million jobs. The Internet Economy exceeded \$500 billion last year alone, and more than 17 million U.S. households shopped online in 1999. This medium has clearly revolutionized our economy, and I think President Reagan best summed-up the Government's view of the economy: "If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

Well, before Government was able to get its hand on the Internet in order to tax it, Congress passed the Internet Tax Freedom Act, of which I was an original cosponsor. I believe it provided a sensible moratorium on the burden of Internet taxation. The act imposed a three-year moratorium on new Internet taxes, while creating the 19-member Advisory Commission on Electronic Commerce. The Commission was given the formidable task of studying the impact of sales and use tax collection on Internet sales and presenting to Congress its recommendations on electronic commerce taxation by April 21, 2000. Today is the first opportunity for Congress to receive and review a summary of the Commission's report prior to the full recommendation.

The Commission first met in June of 1999, and subsequently its members came together three more times, the last being March of this year. Over the last ten months, it was to solve the issue of sales and use taxes on interstate sales of tangible products. I am disappointed that the Commission failed to gain the two-thirds majority necessary for a formal recommendation to Congress. As a result of the Commission's impass and procedural wrangling, several of the most important questions the Commission was given the task of solving, whether Congress should mandate simplification of sales and use tax administration, and whether the existing nexus standards for interstate commerce should be overturned, have not been solved. I admit I am disappointed by the three White House members of the Commission who abstained on virtually every vote, although they took part in the negotiations.

Thus, at the end of the day, the e-commerce community, government, and Americans in general, are left wondering whether a simple and equitable solution to these complex issues will be found. Nonetheless the Commission is to be commended for its hard work and the formidable task it undertook, and a majority of the Commission's members support extending the Congressional moratorium in new Internet taxes for five more years, repealing the 3% telephone excise, banning taxes on Internet access charges, and simplifying the patchwork of state sales taxes. These proposals are a common-sense approach to ensuring that telecommunications services flourish in the e-commerce age.

I commend my friend from Louisiana, Mr. Tauzin; the Chairman of this committee, Mr. Bliley; and the pioneer of the Internet Tax Freedom Act, my friend from California, Mr. Cox, for leading the charge last Congress to ensure Government does not stifle the growth of the Internet. Furthermore, I intend to introduce legislation prior to the April recess, building upon the Commission's recommendations.

I believe codifying the Commission's recommendations is a necessary step in ensuring that the Internet prospers and flourishes, while Congress returns to the task of resolving the remaining questions the Commission was unable to reach a consensus on. The purpose of the legislation is to allow for e-commerce and telecommunications services to grow by first repealing the 3% telephone excise tax that was passed in 1898 to fund the Spanish American War. Last time I checked, we won the war a century ago, but Americans continue to pay a regressive tax, generating annually more than \$5 billion in general revenue. Similar proposals have been introduced in both the House and Senate, and in the 105th and present Congress. Additionally, I believe the current Congressional moratorium on multiple and discriminatory Internet taxes should be extended for at least another five years, while Congress continues to wrestle with issues of taxes on the Internet. Multiple and discriminatory taxes do nothing but increase costs for consumers, and threaten by strangulation the boom and prosperity currently spreading through the telecommunications industry.

I welcome input and participation by my colleagues and look forward to their comments. I hope to build on their efforts in ensuring that the Internet continues to grow free from the burdensome long arm of the government.

Thank you.

PREPARED STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF WYOMING

Thank you, Mr. Chairman, for conducting this important meeting to receive the Report of the Advisory Commission on Electronic Commerce.

Welcome Governor Gilmore.

Internet taxation is one of the issues I hear most about when meeting with local Wyoming officials and small business owners.

These two groups view this matter as an issue of fairness—as do I.

In 1998, when Congress levied a broad three-year moratorium—which by the way I supported—it was thought we could create this Commission to address the issue of multiple taxation of this important new e-commerce.

It was a good idea then and I believe it will continue to be a good idea but not until taxing jurisdictions can clarify and simplify current electronic commerce tax laws.

The issue of fairness has yet to be addressed.

As I stated earlier, I supported the moratorium in 1998, and as many of you know I am not a proponent of levying taxes against the hard working men and women of this country.

However, without the authority to collect taxes on consumers' Internet purchases, in-state retailers are being discriminated against due to the Internet becoming a tax haven for consumers.

Many of us on this committee are former local officials who should understand and take exception to this fact since this disparity erodes state and local tax revenues.

I want to thank Governor Gilmore on his leadership and commend a few of the Commission's proposals.

First, extending the moratorium for five years until we get a handle on how to address multiple and discriminatory taxes on the Internet is a good idea as long as it's taken seriously and gets resolved.

Which leads to the next proposal that encourages states and localities to simplify their sales and use taxes in order to create the fairness or parity I mentioned earlier.

Finally, I agree wholeheartedly that we must repeal the three percent federal excise tax on telecommunications services.

Again, thank you Mr. Chairman for holding this important meeting. I yield back the balance of my time.

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF MICHIGAN

Thank you, Mr. Chairman, for recognizing me.

It's a pleasure to welcome Governor Gilmore this morning. Governor, while I'm keenly interested in your views on electronic commerce, certain members of this Committee could also benefit greatly from your views on interstate waste. I hope that in the future you'll return and that we will be able to help you solve some of the problems you and other states are encountering in your efforts to gain control over the waste shipped into your states.

Much has been reported in the press about the activities of the Advisory Commission on Electronic Commerce, and opinions strongly diverge about the wisdom of its findings and recommendations, among both Democrats and Republicans. But at least one thing is clear: The job was an extremely difficult one, and each of the 19 commissioners is owed a debt of gratitude for their tremendous sacrifice of time and effort on the public's behalf.

The Commission was handed the extraordinary task of sorting out the appropriate tax policies that should apply to the online world of electronic commerce. It was a task that Congress grappled with for some time, but with little success. The Congress hoped that by setting up a Commission composed of industry leaders and representatives of all levels of government, a fair tax policy could be devised that would rationally balance each of the competing interests involved.

Unfortunately, the Commission was unable to achieve the two-thirds consensus required by law to deliver many of its findings or recommendations to Congress. De-

spite the law's specific direction to the contrary, I understand Chairman Gilmore intends to transmit a report that includes even those recommendations that were unable to garner the required 13 votes. That decision is clearly at odds with the statute, and is understandably the source of strong criticism from within the ranks of the Commission itself.

I regret that a great many of us in Congress will be obliged to treat the bulk of the Commission's report as though it were never presented, given the law's clear direction in this matter. And I must emphasize that this is not just a case of blindly following form over substance. The two-thirds majority requirement was included in the law to make sure that Congress could greatly rely on the Commission's findings and recommendations since they were expected to be truly representative of a consensus view.'

The ability of Congress to rely on the strength of the Commission's report is of paramount importance given the enormous stakes involved in this debate. We must find a way to achieve a myriad of equally important goals. We need to protect the future growth of electronic commerce and, at the same time, preserve the viability of traditional producers whose contributions are also vital to the country's economic health.

Just as important, our actions must not put at risk the services provided by State and local governments who depend on sales and use taxes for up to one-half of the needed financing for schools, roads, public safety, and countless other critical services.

It is for this reason that Congress prescribed a super-majority vote on each of the Commission's recommendations. And it is for this reason that we should continue working, as long as it takes, and in a bipartisan fashion, toward finding an answer that promotes and protects all of the substantial economic interests at stake.

Thank you again, Governor Gilmore, for your dedicated service in helping us find answers to these difficult questions. I have every hope that we will, in time, solve this puzzle, and the work of the Commission will have contributed greatly toward that effort.

Mr. Chairman, I yield back the balance of my time.

Mr. TAUZIN. I thank the chairman of the committee, and we welcome Governor Gilmore for his statement. Governor Gilmore?

**STATEMENT OF HON. JAMES S. GILMORE III, GOVERNOR,
COMMONWEALTH OF VIRGINIA**

Governor GILMORE. Chairman Tauzin, Ranking Member Markey, members of the Telecommunications, Trade and Consumer Protection Subcommittee, I want to thank you for inviting me to report on the results of the Advisory Commission on Electronic Commerce, and I'm happy to accommodate the subcommittee's request to come in and speak to them at this point and time, and I will be happy to continue this dialog even beyond this day, but I'm happy to be here today at the request of the subcommittee.

I want to begin by thanking speaker Hastert, Majority Leader Arney, Congressman Biley, and Congressman Rogers for their support of the Commission's work, as well as Senate Majority Leader Lott and Senator Gregg for their efforts and guidance as well. All of these leaders helped us through what was a somewhat difficult process, particularly administratively, and I want to thank them very much for their leadership.

A year of study has confirmed a few important facts. The Internet is the most transforming economic development since the industrial revolution. Information technology is driving America's economic boom, and it's creating new jobs, increased productivity, and efficiencies in every sector of the economy, and generating new wealth in America.

The Internet economy is not just facilitating commerce, it is creating new commerce, and it is empowering individual people in their roles as citizens in a democracy as consumers and as entre-

preneurs. In recognition of these positive realities, the Commission developed a comprehensive set of policy proposals for the 21st century economy, including a number of tax cuts and tax reforms that will directly benefit hard-working men and women and their families and small businesses and entrepreneurs across Virginia—excuse me, across America. You’ve got to excuse me, folks.

First, Congress should eliminate the 3 percent Federal telephone tax, an immediate tax cut of over \$5 billion for the American people each year. This tax was originally established as a luxury tax for the few Americans who own telephones to fund the Spanish American War of 1898. The war is over, and it’s time for the Congress to address this issue in this new information age. In the information age, it is important to reduce the cost of Internet access and to begin to close the digital divide by eliminating the regressive tax on people’s telephones. The policy of the United States ought to be to make the Internet more accessible to people.

Second, Congress should extend the current moratorium on multiple indiscriminatory taxation of electronic commerce for at least 5 additional years, through 2006.

Third, Congress should make permanent the current moratorium on Internet access taxes, including those access taxes that were grandfathered under the Internet Tax Freedom Act to reduce the price of Internet access and to close the digital divide.

Fourth, Congress should prohibit taxation of digitized goods, information, and services delivered electronically over the Internet in order to protect consumer privacy on the Internet and to prevent the slippery slope of extending sales taxes to all services, entertainment, and information in the U.S. economy.

Moreover, this tax prohibition is essential to maintaining U.S. global competitiveness since the United States currently dominates the world market in digitized goods such as software and content.

Fifth, Congress should clarify bright line nexus standards for American businesses engaged in interstate commerce. The cyber economy has blurred the application of many of these legal rules, including nexus standards. American businesses need clear and uniform tax rules. It is a fair warning and a fair assessment of how to conduct business in order to subject themselves to these kinds of obligations. Nexus definition would assist the American economy by doing that. Therefore, Congress should codify nexus standards for sales taxes, in the same way that it acted to define nexus standards for income taxes 30 years ago in Public Law 86-272.

Congress should adopt nexus rules or adapt nexus rules to the new economies dot come and click and mortar business models in order to provide the American people tax freedom on remote Internet transactions, to protect small businesses and medium sized businesses, from onerous tax collection burdens in multiple States and to eliminate costly litigation spurred by confusing nexus rules.

Sixth, the States should undertake a concerted effort to simplify their confusing and overlapping telecommunications taxes and sales taxes and use tax systems. This effort will be particularly important for telecommunications companies and their customers as they built out the Internet infrastructure and offer new technologies and services.

Seven, Congress should close the digital divide by clarifying State authority to spend TANF reserves to provide needy families access to computers and the Internet and by targeting tax cuts and Federal matching funds to public-private partnerships between States and technology companies. Our national goal should be to make the personal computer and access to the Internet as ubiquitous as the telephone and television is today. Within the next decade, we should work to do this and to empower all U.S. citizens to log on and participate in the Internet economy.

Eight, the Congress should respect the paramount importance of consumer privacy when crafting any laws pertaining to online commerce generally and imposing any tax collection and administration burdens on the Internet specifically.

Nine, Congress should encourage the Administration to press for a moratorium on international tariffs on electronic commerce over the Internet.

Now, these are the most important ideas generated in a year of open debate and thorough study. The members of the subcommittee, of course, have been following this along. Everything has been open, on the Internet, reported carefully within the newspapers and in journals, and has been thoroughly examined as an enlarged body of work over this entire year.

Consistent with direction from Speaker Hastert and Senator Lott, some of the Commission's policy proposals will come to the Congress by way of a two-thirds vote, the statutory hurdle for our formal recommendation or finding process, and some will come with a majority vote of 11 to one, with seven votes abstaining. Taken together, they provide Congress a comprehensive foundation for bold and innovative ideas for legislative action that will have a tangible and positive impact on the lives of working men and women and their families.

Now, I believe the Internet is responsible for the advent of a new age of opportunity for American people as citizens, consumers, and entrepreneurs. America's response to this marvelous tool of individual empowerment should not be to tax the Internet and the people who use it, and I believe the ideas generated from this Commission will leave a lasting legacy on a new way of thinking for a new century, and it's a new paradigm for the 21st century.

It's my honor to serve as chairman of this Commission, and I want to thank you very much for inviting me to come and be with you today, and I'm happy to respond to that request of the subcommittee to appear with you today and answer any questions you may have. Mr. Chairman.

[The prepared statement of Hon. James S. Gilmore III follows:]

PREPARED STATEMENT OF HON. JAMES S. GILMORE III, GOVERNOR OF THE COMMONWEALTH OF VIRGINIA & CHAIRMAN, ADVISORY COMMISSION ON ELECTRONIC COMMERCE

Introduction

Chairman Tauzin, Vice Chairman Oxley, Ranking Member Markey, and members of the Telecommunications, Trade and Consumer Protection Subcommittee, thank you for inviting me to report to you on the results the Advisory Commission on Electronic Commerce.

Let me preface these remarks by recognizing the exemplary service of all members of the Advisory Commission on Electronic Commerce. The Congress took great

care in appointing distinguished leaders from diverse perspectives and from the public and private sector.

They include several distinguished leaders from the private sector: Michael Armstrong of AT&T, Grover Norquist of Americans for Tax Reform, Richard Parsons of Time Warner, Bob Pittman of AOL, David Pottruck of Charles Schwab, John Sidgmore of MCI WorldCom and UUNet, Stan Sokul on behalf of the Association of Interactive Media, and Ted Waitt of Gateway. And they include an equally impressive group from the public sector representing state and local governments: Dean Andal, Chairman of the California Board of Equalization, Delegate Paul Harris of the Virginia General Assembly, Commissioner Delna Jones of Washington County, Oregon, Mayor Ron Kirk of Dallas, Texas, Governor Mike Leavitt of Utah, Gene LeBrun of the Commissioners on Uniform State Laws, and Governor Gary Locke of Washington State. And representing the Clinton-Gore Administration were Joe Guttentag of the Department of Treasury, Andy Pincus of the Department of Commerce, and Bob Novick of the Office of U.S. Trade Representative.

These people devoted thousands of hours and their creativity in the service of the hardworking people of the United States. I assure you that these distinguished people accomplished great deeds on the people's behalf. You can be proud of their efforts.

Most importantly, I am proud of the quality of the ideas that will be reported to Congress. Speaker Hastert asked the Commission to send "sound policy proposals for the individual taxpayers of America," and Senate Majority Leader Lott requested us to forward "a clear and unambiguous policy proposal... especially if that proposal is bold and innovative." That is precisely what the Congress will receive.

The Commission Has Successfully Fulfilled Its Charge

The Advisory Commission on Electronic Commerce was established by Congress to conduct a thorough study of federal, state, local and international taxation of electronic commerce. For the last 10 months, 19 Commissioners have been deeply engaged in that endeavor.

The Commission held its first meeting in Williamsburg, Virginia, in June of 1999. We met again in New York City in September, and then again in San Francisco in December. The Commission held its last meeting in Dallas, Texas, in March of 2000, and then concluded its business on a conference call a week later.

The Commission came a long way in 10 months. Since June of last year, the Commission heard testimony from over 55 experts, academics, think-tanks and interest groups representing a broad range of perspectives on tax and electronic commerce policy. Each Commissioner was able to invite their own experts to express a viewpoint. We heard from every quarter, from the Heritage Foundation to the National Governor's Association and Wal-Mart.

The Commission also received over 7,000 pieces of mail and over 50,000 e-mails. Every viewpoint has been heard. The Commission's library has grown to over 280 selections. Our Website received an award from MuniNet -- it was selected as one of that publication's top sites for 1999. That website will be archived by the Library of Congress for posterity. Our Commission has been viewed by hundreds of thousands of people on C-SPAN and via webcasts of our meetings.

By the time the Commission arrived in San Francisco in December, we had distilled dozens of issues into a "Policies & Options" Paper. That paper guided an open and engaged debate at the San Francisco meeting and propelled the Commission to our final meeting in Dallas where we voted on specific policy proposals and attempted to come to constructive policy conclusions in the best interests of the American people. I am confident that conclusions we reached will indeed benefit the people of the United States with regard to the taxation of electronic commerce.

In short, the Commission fulfilled its public obligation to engage and educate the people of the United States on the policy of Internet taxation, and its statutory charge to report the results of our study to Congress no later than April 21, 2000.

On behalf of the Commissioners, I extend our special appreciation to Speaker Hastert, Majority Leader Arney, Congressman Bliley and Congressman Rogers for their support in making the Commission a success, as well as Senate Majority Leader Lott and Senator Gregg for their efforts and guidance. I also applaud the foresight of Senator Wyden and Congressman Cox in sponsoring the Internet Tax Freedom Act which created the Commission.

The Internet is Driving the New Economy

A year of study has confirmed at least a few important principles. The Internet is the most transforming economic development since the Industrial Revolution. Information Technology is driving America's economic boom—creating new jobs, increasing productivity and efficiencies in every sector of the economy, and generating

new wealth in America. The Internet economy is not just facilitating commerce—it is *creating new commerce*. And it is empowering individual people in their roles as citizens in a democracy, as consumers, and as entrepreneurs. Every person on the Commission recognized that our national economy, U.S. global competitiveness, and American culture depend vitally upon nurturing full development of the Internet.

I believe the Internet and information technology, combined with the creativity and hard work of the American people, are responsible for the advent of a new Age of Opportunity. For the first time ever, consumers can locate perfect information and access to goods and services at the touch of a button, and small businesses and entrepreneurs can—for the first time in history—reach a global marketplace and compete with big, capital intensive companies. The result is a digital marketplace even Adam Smith would marvel.

Evidence that the Internet is driving America's economic boom abounds and was most recently documented in a study conducted by the University of Texas' Center for Research in Electronic Commerce. According to the study, the nation's Internet-based economy grew 68 percent last year to produce over \$507 billion in business revenues. The Internet economy has created 2.3 million new jobs. The Internet and information technology sector now accounts for more than half the capital investment in our country. And of the tens of thousands of new businesses being created every year, research shows nearly one in three did not exist prior to 1996. One sector of the Internet economy—electronic commerce—accounted for nearly 1 million of the 2.3 million jobs created by the Internet.

Even in rural areas long ago ignored by the economic progress in metropolitan areas and bypassed by the Nation's huge investment of public resources on the interstate highway system, small businesses are prospering by selling products worldwide. The Virginia Diner in rural Wakefield, Virginia, is a perfect example. The nation's huge investment of tax dollars in the interstate highway system left Rt. 460, a classic small town "Main Street," virtually abandoned years ago. Those people who happened through Wakefield could stop into the Virginia Diner and buy a cup of coffee and a can of Virginia peanuts. But the Internet economy has empowered VaDiner.com to sell Virginia peanuts to consumers from Spain to California to Tokyo. Due to the boom in Internet sales, the Virginia Diner has increased its employment in Wakefield from 70 to 120 employees over the last three years and this year the Diner will invest over \$100,000 in new computer hardware and software.

This new economic activity, increased productivity and job creation is generating new wealth and increasing tax collections by governments. Indeed, the Internet economy has local, state and federal tax coffers fuller and growing faster than ever through the massive job creation and capital investment occurring in every state in the Nation. The National Governor's Association reports that the states collectively took in \$11.3 billion in tax surpluses in 1998 despite tax cuts totaling \$5.3 billion in 1998 and \$4.9 billion in 1997. And end-of-year balances for all states totaled \$35 billion by the end of 1998. In 1999, the states collectively took in \$7.5 billion in tax surpluses despite additional tax cuts totaling \$7 billion. Sales taxes in particular continued to increase in 1998 and 1999—the states collectively took in surpluses of *sales taxes* totaling \$2.3 billion in 1998 and \$2.2 billion in 1999 as people spent their new wealth.

The Challenge for Public Policy—Government Must Change

Underlying all the documented numbers is a profound social and economic transformation. Every sector of our society is challenged to adapt to the new Internet economy. Business is being conducted differently. Business models are changing. Companies are more efficient and productivity per employee is increasing exponentially. The same transformations are occurring in education, in the way Americans live, obtain information and conduct their own lives. Fundamentally, this technology empowers. It empowers businesses, business leaders, employees, educators, and mostly it empowers each individual citizen.

All of this evidence validates the maxim: *The Internet changes everything*. More to the point, the Internet changes everything *including government*. Old rules do not work well in this new borderless economy. Sometimes they do not work at all. Regardless, change is everywhere, and government has to change as well.

In the Internet economy, government at all levels must change its *policies* as well as *the way it operates*. The Internet is driving a 15 percent increase in revenues and productivity per employee in the private sector economy, according to the University of Texas' Center for Research. Government must marshal the Internet to become equally as productive per public employee in the delivery of government services. The result should be a dividend to American taxpayers through lower-cost, more efficient government. The savings should be re-prioritized to other government serv-

ices so that no city goes without fire trucks or schools, and taxes should be kept low.

Policy Prescriptions for the 21st Century

That brings me to policy prescriptions for the 21st Century economy. I point out that some of the Commission's policy proposals will come to the Congress by way of a two-thirds vote—the statutory hurdle for a proposal to take on the elevated status as a formal “recommendation” or “finding.” On issues such as international tariffs, consumer privacy, and the digital divide, we came to two-thirds votes, though I was disappointed representatives from the Clinton-Gore Administration abstained on these consensus issues. On a host of core tax issues, the Commission came to a clear majority by a vote of 11 to 1 (with 7 votes abstaining) and we will share the results of our work on those topics with you, as well, as requested by Speaker Hastert and Senate Majority Leader Lott.

Let me provide one disclaimer regarding my personal opinion which is the position I advocated within Commission debates. I believe that no taxation is presumptively necessary. To the contrary, the presumption should favor the right of individual citizens to keep their own hard-earned money. Government must prove a tax is absolutely necessary for the provision of essential services before taxing a new realm of economic activity or human endeavor. Government has no right to expand tax burdens on Americans just because a similar commercial transaction is taxed. Government should take only what it needs to operate government and stop there.

And in the context of electronic commerce, America's response to the Internet revolution should NOT be to tax it or all the people—the individual taxpayers, consumers and small businesses—who have been empowered by it. In my view, the history of the 20th Century was about bigger government built at the expense of hard-working people. But the 21st Century offers the promise of smaller, more efficient government and a proportionate increase in the economic freedom and liberty of individual people who are permitted to keep more of their own money.

In my view, the Internet changes everything, including government. Government at all levels must begin now to harness the efficiencies and productivity increases facilitated by Information Technology and the Internet. Free enterprise is doing it. Government must do it, too.

That opinion was not shared universally on the Commission. Nevertheless, a majority of Commissioners approved policy prescriptions that, in my view, advance these objectives. Among the ideas submitted in this Report, you will find proposals for the following tax cuts and tax reforms:

- First, Congress should eliminate the 3% federal telephone tax—an immediate tax cut of over \$5 billion annually for the American people. This tax was originally established as a luxury tax for the few Americans who owned a telephone to fund the Spanish American War of 1898. Since that time, it has been scheduled for extinction for decades, but was finally made permanent in the late 1980s. In the Information Age, it is important to stop taxing people's telephones. Elimination of this regressive tax is an important first step in reducing the expense of Internet access, one of the contributing factors to the digital divide. While this tax once was justified as a luxury tax on the few Americans who owned a telephone, it has no rationale in the Information Economy.
- Second, extend the current moratorium on multiple and discriminatory taxation of electronic commerce for an additional five years through 2006.
- Third, prohibit taxation of digitized goods sold over the Internet. This proposal would protect consumer privacy on the Internet and prevent the slippery slope of taxing all services, entertainment and information in the U.S. economy (both on the Internet and on Main Streets across America). Moreover, this tax prohibition is essential to maintaining U.S. global competitiveness since the United States currently dominates the world market in digitized goods.
- Fourth, make permanent the current moratorium on Internet access taxes, including those access taxes grandfathered under the Internet Tax Freedom Act. This proposal is another crucial initiative, targeted to reduce the price of Internet access and to close the digital divide. By expanding the moratorium to eliminate the current grandfather provision, consumers across the country would participate in electronic commerce without onerous tax burdens.
- Fifth, establish “bright line” nexus standards for American businesses engaged in interstate commerce. The cyber economy has blurred the application of many legal nexus rules. American businesses need clear and uniform tax rules. Therefore, Congress should codify nexus standards for sales taxes in a way that adapts the law of nexus to the New Economy and the new “dot com” business model. Codification of nexus would serve several important policy objectives: (1) provide businesses “bright line” rules in an otherwise confusing system of state-

- by-state nexus rules; (2) protect businesses, especially small businesses, from onerous tax collection burdens; (3) reduce the amount of costly litigation spurred by confusing nexus rules; (4) nurture the full growth and development of electronic commerce; and (5) give consumers and individual taxpayers who participate in Internet commerce a tax break.
- Sixth, place the burden on states to simplify their own labyrinthine telecommunications tax systems as well as sales and use tax systems to ease burdens on Internet commerce. This effort will be particularly important for small and medium-sized retailers with nexus in two or more states. It also will be important for telecommunications companies as they build out the Internet infrastructure and offer new technologies and services. Radical simplification will be necessary in the New Economy if small and medium-sized businesses are to succeed.
 - Seventh, clarify state authority to spend TANF funds to provide needy families access to computers and the Internet, as well as the training they need to participate in the Internet economy. This is one strategy the Commission formally recommends to close the digital divide and make the personal computer and access to the Internet as ubiquitous as the telephone and television.
 - Eighth, provide tax incentives and federal matching funds to states to encourage public-private partnerships to provide needy citizens access to computers and the Internet. This is yet another strategy the Commission formally recommends to close the digital divide.
 - Ninth, respect and protect consumer privacy in crafting any laws pertaining to online commerce generally and in imposing any tax collection and administration burdens on the Internet specifically. This is a formal recommendation of the Commission.
 - Ten, continue to press for a moratorium on any international tariffs on electronic transmissions over the Internet. This idea also is a formal recommendation of the Commission.
 - And eleven, a majority of the Commission endorsed a comprehensive framework for addressing international tax and tariff issues based upon the following core principles: no new taxes or tax structures on electronic commerce in the world marketplace; tax neutrality toward electronic commerce; simplicity and transparency of tax rules applied to electronic commerce; and a call for the Organization of Economic & Community Development (OECD) to continue fostering international dialogue and cooperation on international tax issues.

These are the key ideas generated in a year of open debate and thorough study.

As you can see, the Advisory Commission on Electronic Commerce has been busy. Some of our ideas obtained a two-thirds majority to rise to the level of formal "recommendations" while others obtained a clear simple majority by a vote of 11 to 1 (with 7 votes abstaining). Taken together, they comprise a comprehensive package of ideas to inform Congress of the comprehensive array of tax issues implicated by the Internet. Consistent with direction from Congressional leadership, the Commission has provided Congress a bold and constructive foundation for legislative action that will have a tangible and positive impact on the lives of working men and women and their families.

It has been my high honor to serve the people of the United States as Chairman of the Advisory Commission on Electronic Commerce. I thank the Congress for entrusting me with this critical role in shaping ideas for the 21st Century. I thank my fellow Commissioners for their keen insights and creativity and, most of all, for their great sacrifices of time and effort in the service of our Country. Few chairmen can claim to have presided over a more distinguished assembly of public and private leaders. The Commissioners can be satisfied their labors have advanced the best interests of the people of the United States, and the Congress can be proud of the quality of ideas they have delivered. These ideas will leave a lasting legacy on a new way of thinking for a new century. This Commission has rung a bell for the 21st Century and a new paradigm in America. For that, I am very proud.

Thank you for inviting me and I would be happy to answer any questions.

Mr. TAUZIN. Thank you very much, Governor. The Chair will yield himself the appropriate time and yield that time to the author of the legislation which created the Commission, the gentlemen from California, Mr. Chris Cox.

Mr. COX. Thank you, Mr. Chairman, and welcome, Mr. Chairman and Mr. Governor. Your leadership on this Commission is truly something for which the Nation should be grateful. I think all of us on this committee who wrestled with this legislation in the first

instance recognized how difficult these issues are. Whenever you are considering changing the rules for not just the Nation's economy but the global economy, there are a lot of special pleaders, and a lot of people affected by this, and so it cannot be easy. What you have done, lending dignity to the proceedings and making sure that the intellectual product has been so substantial is something for which I think all of us are truly grateful.

As Chairman Tauzin has indicated and as you know, I didn't invent the Internet, but I can claim some credit for inventing the Internet Tax Freedom Act along with Ron Wyden, an alumnus of this committee who's now in the Senate. Our purpose in including in the legislation that bans new, multiple, and discriminatory taxes on the Internet, including in that legislation a commission, was to recognize our own shortcomings. We wrote this legislation 2 years ago, and the new economy has developed amazingly since that time. We couldn't know 2 years ago even what all of us in this room know today about technology, and we have to recognize our own limitations in looking forward.

What you have been able to do is bring a lot of expertise from across the country and around the world to bear on the question of what should our tax policy be for the 21st century. We cannot apply the tax policies developed for smokestack industries to the new economy. So, I'm very impressed that you have come up with so many recommendations and that they are in fulfillment of the charge most recently given by the speaker of the House and the Senate majority leader, truly bold and innovative, and you didn't go for a sort of dumbing down to the lowest common denominator to achieve consensus.

Two of your recommendations are particularly striking, and I want to ask you about those. First, you ought not only to extend the current moratorium on new, multiple, and discriminatory taxes, and you want not only to permanently ban Internet access taxes, but you want to include in that ban a few taxes that were grandfathered because they were already on the books before Congress could act a few years ago. I want to ask you about that and about the repeal of the Spanish-American War tax, whether or not in both cases you have a two-thirds vote.

Governor GILMORE. Congressman, the sense of the Commission as we went along was that there were burdens on telecommunications, burdens on the Internet that ought to be eliminated. There was a proposal that came forward that drew an 11 to 1 vote but did not reach the 13 vote, so that was a part of this, but the Commission's report, while it is not a recommendation, the Commission's majority report has come forward and suggested that we ought to, in fact, extend the moratorium but to recognize that there was a flaw in the moratorium, that the moratorium as currently constituted contains grandfathering clauses to continue to allow taxation on Internet access if it previously existed.

In the interest of consistency and the growth of the industry and the opportunities for working men and women everywhere, because after all, it's individual citizens that pay this access tax, not businesses, the report that will be coming forward will suggest that the Congress, in fact, eliminated those grandfathered taxes and have a consistent across the board approach that says we should not be

taxing access to the Internet. That will be an extension or an addition to the current moratorium which we believe is too limited at this point. Also, the—

Mr. COX. I'm sorry, Governor, was the Commission essentially unanimous on that point or was—

Governor GILMORE. No, it was not, as a matter of fact. The proposal came forward with this and a number of other proposals, and that passed as a part of the report at 11 to one with seven abstentions, but it was not a consensus by any means, to my amazement.

Mr. COX. I see. But in fact, there was only one vote against it.

Governor GILMORE. That's correct. There were seven abstentions. Please understand, Congressman, that the way that this act was structured, if the conclusion had been that there was—if the Congress's direction had been interpreted, there could be no work product of this Commission in the absence of a 13 vote or better, then we should never have bothered to have met, but I don't believe that's what the Congress intended.

Mr. COX. What I can tell you, since I at painstaking length wrote those provisions with Governor Leavitt and mostly in my office, that at least what the author of the legislation had in mind was that if we were going to have a Congressionally chartered commission recommending higher taxes on the Internet back to Congress, I wanted that to be a two-thirds vote. We didn't want to make it easy for a commission to go out and recommend higher taxes and come back to us. I think it's abundantly clear that there was no recommendation to tax the Internet that received a two-thirds vote, and so the purpose of the two-thirds provision has been met, but I agree with you. We are interested in the information that you assembled, and it was certainly not the intent of the legislation to prevent the commission from reporting back everything that it wished to report back to us. In fact, I think I may have had the opportunity to mention, publicly or private before, that when I served as a Presidential appointee appointed by President Clinton on another commission that was looking at Social Security taxes, also a tough issue, the so-called Entitlement Commission, the Cary Danforth Commission, that the only way we could put out a report was to have every single one of the commissioners put down his separate views, and that's what we did. The people of the country deserve a report back, and the fact that you had an 11 to 1 vote, it seems to me, puts a lot of weight behind your recommendations.

Governor GILMORE. Yes, sir, an 11 to 1 vote to eliminate all access taxes to the Internet and also to eliminate this 3 percent Spanish-American war tax as well came out at 11 to 1. There was a more pro-tax plan that was brought forward, but it never mustered more than eight votes, and therefore never even rose to any type of majority of any kind.

I agree, as chairman, I believe I certainly tried to follow the Congress's guidance on this. The Congress certainly wanted to have our information, and then of course, it would be persuasive to the Congress if we ever did achieve a two-thirds majority on anything which, of course, we did in two areas. Otherwise, we thought that this information and the work product of the Commission should come forward to the Congress for the value that Congress wishes to give it.

Mr. TAUZIN. The gentleman's time has expired.

Mr. COX. I thank the chairman.

Mr. TAUZIN. The Chair now recognizes the gentleman from Massachusetts, Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman, very much. If we could step back for a little bit, I think that just by the fact that we are debating Internet taxation, we necessarily are debating all taxation because, of course, if we are going to exempt one part of the American economy from taxation, we have to necessarily talk about increase in taxation in another part of our economy. There's just no way around it. We have a certain amount of Medicare, Social Security, education, fire, go right down the whole line, of services which Americans need, and there's a finite amount of money which has to be produced in order to accomplish those goals.

So, if we assume that no one's talking up here about reducing the amount of revenue that is available at the State and local, for that matter, national level, then we have to keep that number constant. Now, if we're having a different debate, which is that this should be something which is viewed as a tax cut, a tax cut that leads to revenue reductions which reduce our capacity to be able to deal with police, fire, education, Medicare, Medicaid, then that's a different debate, but it's necessarily part of the discussion which we have to have.

So, in yesterday's National Journal, quite interestingly, Bill Archer, the chairman of the Ways and Means Committee, along with John Linder and Collin Peterson, a Democrat, all talked about essentially moving to a 23 percent national sales tax as the form of raising revenue here for the Federal Government, doing away with the income tax.

Now, if we move to a national sales tax, I guess my question would be under your proposal, would there be a capacity to tax any of the revenue which is generated by means of retail sales online?

Governor GILMORE. Congressman Markey, there wasn't anything in this Commission that suggested that we ought to have either a national sales tax or that one was necessary.

Mr. MARKEY. No, I mean if we did move to that model, that the chairman of the Ways and Means Committee is now proposing that we have a national sales tax, would we under your proposal merge with that proposal, if both became law, be able to tax Internet online retail transactions.

Governor GILMORE. The Commission never found that there was any evidence that was persuasive, at least to the majority of the group, that said that there was a necessity for a national sales tax or that one, in fact, ought to be imposed. In fact, even moving beyond that to the question of the State and local sales taxes which was the central issue that we addressed, we took note of the fact, of the evidence that was presented to us, that the States and localities are awash in money, that as the Internet economy grows, nonetheless, the States and localities are not losing money. They are gaining money. The States collectively took in \$11.3 billion in tax surpluses in 1998, despite even tax cuts during 1998, \$4.9 billion in 1997. End of the year balances on rainy day funds are awash in money. The States took in \$7.5 billion in tax surpluses despite additional tax cut, and as it grows—

Mr. MARKEY. If I can just interrupt you briefly.

Governor GILMORE. Yes, sir.

Mr. MARKEY. Because Massachusetts and Virginia kind of vie for a very close second with Silicon Valley in terms of this entire area, so I agree with you that we are awash in money today. Unfortunately, we already lived through one Massachusetts miracle that created a candidate of some note running for the presidency in Massachusetts in 1988. Unfortunately, that miracle did evaporate for 3 or 4 years, and tax revenues did diminish greatly. So, we can't really predict the weather of 2 or 3 or 4 years from now by looking out the window today.

So, I guess my question to you, Governor, is this. Do you personally support doing away with all taxation, including sales taxes on the Internet, even if—and again, it's an integrated debate—Bill Archer and the Republican party here, move for a national sales tax to replace the national income tax. Where would you stand on that issue?

Governor GILMORE. Well, first of all, Congressman, let me just say that the Commission has produced a majority report that does not think that we have any necessity of producing additional sales taxes in order to fund those State services that you were speaking about, and it is not correct to say that all sales tax issues are tied up with Internet sales tax issues. It is not necessarily the case that one goes hand in hand. The question that was before the Commission is in this new area of commerce, is it a necessity either philosophically or as a matter of funding of State government to extend taxation into this new area, and the conclusion of the Commission was that it was not.

My personal view is that we can strike a reasonable balance that, in fact, makes it very clear that we can collect the revenues. We can put all of this into effect without extending those tax obligations onto the Internet.

Mr. MARKEY. See, Governor, if I may just for 10 seconds just summarize that we had another distinguished alumnus of this committee, David Stockman, who argued quite persuasively in 1981 that a central fallacy was possible to be accomplished, which was we could cut taxes dramatically, increase defense spending, and balance the budget simultaneously. We always admired his ability to an eye-watering detail defend knowingly erroneous premises, okay? He was great at that, but we really can't argue with the one hand that we can cut taxes and continue to fund at the same time existing social service programs at the same level. I appreciate your testimony here today. Thank you.

Mr. TAUZIN. Thank you, Governor. Mr. Markey, it just occurred to me as an observation that the Massachusetts economy and the Presidential candidate sort of both went into the tank at the same time.

Mr. MARKEY. It's something that hasn't been lost on us politically. Governor Weld's whole career is premised.

Mr. TAUZIN. I thank you, my friend. The Chair recognizes the gentleman from Richmond, Virginia, the chairman of the full committee, Mr. Bliley.

Chairman BLILEY. Governor, the Commission spent some time looking at this issue of State and local taxation of Internet access,

and I note that the majority concluded that Congress should eliminate all such taxes because the impact these taxes have on consumer demand for Internet access services, is that correct?

Governor GILMORE. Congressman, you were asking whether or not—I'm sorry, repeat your question.

Chairman BLILEY. The Commission spent some time looking at the issue of State and local taxation on Internet access.

Governor GILMORE. Yes, on access, yes, sir.

Chairman BLILEY. And I note that the majority concluded that Congress should eliminate all such taxes, is that correct?

Governor GILMORE. That is correct, Congressman.

Chairman BLILEY. I also note that the FCC imposes access charges on long distance carriers for the cost of using the local telephone network and that some have raised concerns that the FCC might some day extend access charges to Internet service providers. If so, would FCC impose access charges raise the same concerns? In other words, would access charges on Internet access have the same consumer impact as taxation of Internet access?

Governor GILMORE. Congressman, I think it would. The Commission did not address this specific issue, but they did address in general the burdens that are placed upon individual working men and women who have to pay fees in order to have access to the Internet, in order to close the digital divide and to make the access to the Internet more available to every American. It was the sense of the Commission that Congress ought to reduce every burden that it possibly can. I would think that the issue of whether or not there was to be access fees charged to Internet companies which then might be passed on to individual working men and women would be a concern of the Commission because we addressed it in other ways, like the 3 percent excise tax and like taxation on Internet access.

Chairman BLILEY. Some pro-tax advocates are arguing that the Commission's report is laden with special interest favors for big business. Could you walk us through the tax cuts and tax benefits for individual citizens?

Governor GILMORE. Yes, sir. I think that it is not fair and probably just an effort by pro-tax people to try to knock down the Commission report to suggest that somehow this is some group of special interest legislation. I don't think that's right at all. Certainly the sense of the conservatives on the Commission was that we were in it for the people of the United States. We wanted to try to deliver tax cuts to the people of the United States, and I think that the Commission report does propose that, and specifically, it suggests that we should eliminate the 3 percent excise tax on telecommunications, again, that was imposed almost a century ago to fight the Spanish-American war. The reason you do that is not because businesses pay the tax but because individual working men and women pay the tax on telecommunications, which is a burden on access to the Internet.

There was a proposal—there is a proposal to eliminate the access taxes on the Internet that even today are imposed by certain States and localities, not because businesses pay those taxes but because working men and women and families pay those taxes across the country. So, certainly there are those proposals.

There is a proposal that we come forward and define what nexus means, as we in fact have done, as the Congress did in the case of income taxes. We do that in the case of sales taxes as well, and that will give fair warning to businesses, when especially small business, that when they engage in this activity as to what is going to subject them to tax collection obligations or other kinds of obligations as well.

There, of course, are proposals that the Congress also urged that there be no taxes on digitized goods. If you begin to go toward the taxation of digitized goods, then you have to find a way to impose that tax. To do that means that you just have to simply invade the transactions on the Internet of individual people that are doing business with every retailer across the world globally on the Internet, and you have to understand what that transaction is and it has to be reported to some government some place.

One place we did rise to a two-thirds majority was privacy concerns within this Commission, is the recommendation of this Commission, a full recommendation that the Congress be very sensitive to privacy concerns. That means that we have to be very alert to the fact that the invasion of these transactions is a potential invasion of privacy, which would mean, by the way, that people will not use the Internet if they think that all of their information is going to be made available to anyone. Privacy is a very key issue in that area.

There of course are approaches also to address the digital divide, something that's very near and dear to my heart. We believe that—the assertion that was made a little while ago that this is somehow a suggestion that this is a system for the rich is a very backward looking approach. We have to recognize that just as the phone has now become available to everyone, the Internet, that must be the goal of America, to make the Internet available to everyone as well.

So, to close the digital divide by the use of TANF funds and other efforts and partnerships between government and localities and States and private businesses in order to make more people have access to the Internet should be our goal.

These are all the proposals that are included in one form or another, recognizing of course that the privacy concern rises to that dignity of the two-thirds proposal.

Chairman BLILEY. Thank you, Mr. Chairman. I see my time has expired.

Mr. TAUZIN. I thank the gentlemen. The Chair now recognizes the gentlelady from California, Ms. Eshoo, for 5 minutes.

Ms. ESHOO. Thank you, Mr. Chairman. Governor, I'd like to go back to some of the underlying themes that I expressed in my opening statement.

Governor GILMORE. Yes, ma'am.

Ms. ESHOO. Because I think that it's important to establish the context. Do I believe that there are many areas where essentially weeds have grown around this system where there are overlays in terms of our taxes and taxing system that really should be removed from the books? Of course I do. I have the privilege of representing a Congressional district that is the prime engine in our Nation that has caused the expansion in our economy that produces not only the ideas, possesses the intellectual property, and makes them real

in our Nation, which is Silicon Valley. So, I think that I have a first-hand view, a very deep and broad view, and appreciation of the issues that have brought the Internet to the place that it is today and will continue to make cyberspace one of the most exciting and economic privileges for our Nation and for the world.

I want to go back to a couple of things because I think something is getting ahead of us here, and that is that the Commission produced what you are here reporting on today, and that is not the fact. Can you tell us how many Governors supported what you have brought forward today?

Governor GILMORE. How many Governors, Congresswoman?

Ms. ESHOO. Uh-huh.

Governor GILMORE. I haven't taken a count on Governors. Our goal here was to work with the 19 members of the Commission, of which only three Governors, of course, were appointed to the Commission, and I haven't taken a count. I know that when I spoke at NGA, I thought that many of the Governors were very ambivalent about, as a matter of fact, about what the right approach was and were willing, like I have been, to keep an open mind and to listen and to actually get the facts and the evidence.

The key point here is, I think, is that of the State and local representatives that were appointed to this Commission, four supported a strong pro-tax position and three supported a strong anti-tax position. I might say that Andal of California and myself represent more people than all the others combined that were, in fact, in favor of pro-taxes.

Ms. ESHOO. Are you aware of the language that established the Commission that stated that no finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission? I think that's very important. I think that, you know, if I were on the flip side of the questions that I'm asking you, that it could be suggested that I'm filibustering and that I want to tax everything to death. That's not the point. I think we need to be very fair about this and understand the context in which you come before us today. Why was Governor Leavitt not allowed to even submit some minority view?

Governor GILMORE. Two points, Congresswoman. First of all, the report itself did not require a two-thirds consensus to be yielded up to the Congress. In fact, I would not think that Congress would want all this work to be done, this body of information to be thrashed out and then not be able to submit any kind of report because a solid block of pro-tax folks would block any report. I think that was the effort, really, of the abstention votes, but it didn't work because you can't have a tyranny of the minority, and I don't think that the Congress dictated it.

Ms. ESHOO. Governor, with all due respect, I don't think what the Congress established was tyranny. I think that they established something—

Governor GILMORE. No, no, I didn't suggest that.

Ms. ESHOO. [continuing] that would bring forward—

Governor GILMORE. You misunderstood me.

Ms. ESHOO. [continuing] a broader consensus on an issue that is—I mean, this is like trying to get socks on an octopus. I'm not suggesting that this is an easy task that was presented to the Com-

mission, but to suggest that the majority, and in a draft report that we really haven't seen, is the final consensus of the Commission that you headed I think blurs the case. I don't think that it's fair. That's what I want to establish.

Governor GILMORE. Let me ask you directly. The statute does not demand that two-thirds be obtained before a report can come forward. Recommendations yes, but we're making it very clear that many of the proposals cannot rise to the level of recommendation, but the Congress is entitled to what they asked for, which is a report.

Ms. ESHOO. Well, the report can be filed, but any findings included must be approved by two-thirds of the vote. That's what the legislation said. I mean, we're all taking credit for the votes that we passed on the Internet taxation legislation, but that's the language that was in it. Now somehow we're throwing the language overboard but we want our votes to stand, and we're coming in here somehow fully accepting what your presence brings forward, and that's not the case.

Governor GILMORE. I understand, Congresswoman.

Ms. ESHOO. Are you willing to stipulate to that?

Governor GILMORE. No.

Ms. ESHOO. You're not?

Governor GILMORE. No, because the language of the statute makes it very clear that a report will come forward, and we have been very fair and open and honest with the——

Ms. ESHOO. But that's only half. You're saying that the legislation, yes, stipulates that a report can be filed, but any findings that are included have to be approved by a two-thirds vote.

Governor GILMORE. And we have so——

Ms. ESHOO. The Commission did not do that.

Governor GILMORE. And we have so designated within the report those matters that rose to that level of dignity and those that did not. Anything that was a majority report has come forward, which I think is the——

Ms. ESHOO. Let me just, because this is my time, the NGA is opposed to your recommendations, and it's been reported that as many as 44 Governors support the NGA view. So, we have a mixed view. There is a mixed view in the country out there by the chief Constitutional officers of States. You know, at the end of the day, maybe what the majority brought forward the Congress will accept. We haven't arrived there yet, and I don't want this record to be blurred to suggest that it is all one and that it isn't some of the other.

Ms. ESHOO. I think that's an unfair view.

Mr. TAUZIN. Gentlelady, your time has expired.

Governor GILMORE. I must respond, Mr. Chairman, to the second point which I haven't gotten to, which is the issue of a minority report. It was the sense of the Commission that matters that could not obtain even a majority ought not to be included in the report of the Commission. However, the Commission was extremely liberal in this, or shall I say generous in this, by having each Commissioner have three pages to summarize his point of view, whether it could command a majority or a super majority or not. In fact, the report will obtain statements from each of the Commissioners,

which is basically a whole series of majority, consensus, and minority reports all together. In fact, I ruled as chairman that any of the Commissioners that wish to get together and submit a so-called minority report by combining their space could get pages and pages and pages. I don't know that they've done that, but every minority view is going to be thoroughly represented within the final report.

DR. POWERS: The gentlelady's time has expired. The Chair recognizes the gentleman from Ohio, the vice-chair of the subcommittee, Mr. Oxley.

Mr. OXLEY. Governor, welcome, and congratulations for a job well done.

Governor GILMORE. Thank you.

Mr. OXLEY. The now infamous excise tax that funded the Spanish-American War, the most expensive war in American history, continues unabated. If you tax something, you get less of it. In this case, I think if you tax something, you get less growth, and certainly in this case growth of the Internet.

It's interesting that the tax that was imposed in 1898 was a luxury tax. That was, there were very few people that had working telephones, and obviously we've moved now to a situation where 97 or 98 percent plus of Americans have telephones. Most of them have more than one in their homes. Now we have the advent of the Internet and the growth of the Internet. I wonder if anybody would consider that to be a luxury in today's market. I doubt it. It has become such an ubiquitous part of American life that you would be very hard-pressed to call it a luxury and yet, in fact, Americans are still paying that luxury tax. I congratulate you for your strong position on that particular issue, and hopefully Congress can do something about that.

The Ohio delegation met with Governor Taft yesterday, and he obviously, from his position, has some concerns about the recommendations, and I appreciate where he's coming from. You indicated in your report and in your testimony that government must change, and that is true. How can State governments, in your view, adapt to the new realities of the information age, specifically in terms of creating or getting enough revenue to run State government to provide education and the like, and how much time will they have to do that? It seems like a rather heavy lift from where I sit, but could you kind of take us through what your vision of that might be?

Governor GILMORE. I think we need to explode the myth that somehow the Internet is a threat to services by State and local governments. There's no substantial evidence of that. There's speculation that perhaps someplace, somewhere that there will be such a move of E commerce over that there might be some diminution of sales tax revenues, but there's no evidence of it, no facts of it. All the facts are to the contrary. As the Internet grows and as the Internet sales continue to grow, revenues are going up in the States.

I think we need to, in simply grasping for additional sources of old traditional thinking about sales taxes which were put on during the depression era, for heaven's sakes, I think we need to, in fact, accept this medium and to recognize it for what it is, and that is an opportunity for increased productivity, for growth of an industry

that we have not seen before, for the employment of more and more people, for the raising of additional revenues, if you will, as a result of the growth of this industry. We're seeing more and more people shopping, more increased opportunities for commerce, more productivity, and as a result of that, revenues are going up, not down.

So, I believe that we should just not grasp onto old ideas that are fearful about the idea that revenues may be going down when, in fact, the evidence is to the contrary. Revenues are going up.

Mr. OXLEY. So you would not necessarily advocate a radical change in, at least in the short term, the States tax structure, is that correct?

Governor GILMORE. It's not necessary to attack the sales tax generally in order to exempt the sales tax on the Internet. It's not necessary to do that. You can exempt sales taxes on the Internet without threatening the sales tax within the States and the localities. There's no evidence that one is going to destroy the other.

Mr. OXLEY. I understand that your Commission dealt, or at least talked about the practical realities of tax collections in the States over the Internet, of retail business conducted over the Internet. In my home State, for example, we have a piggyback tax so that counties can levy a piggyback tax on top of the State sales tax. It just seems to me it would be so difficult in all of those jurisdictions. Our State may treat taxation of clothing different than other States. The same kind of things with food items or drugs. Is that a very practical problem that you also dealt with?

Governor GILMORE. You've asked a very central question, and it was dealt with extensively within the Commission, and Governor Leavitt asked for an opportunity to go away after our New York meeting and come back in San Francisco in order to produce a technological fix on this, a solution that would, in fact, be able to solve all of these problems through technology and make taxation of the American people on the Internet something that could be imposed. Couldn't do it, and I'm not sure that it is possible to ever do it.

This is a dramatic change in the way that government has to understand its limitations of its powers in the future. This is a confidential conversation going on between buyers and sellers across the entire globe. No technology exists to capture all of that, and to capture that information in order to produce this type of sales tax that we have traditionally seen at the cash register when you have your consumer standing right there with you. So that is, in fact, a very difficult technological difference in this that we have not yet been able to solve, and I'm not sure that it's ever going to be solvable.

Mr. OXLEY. Thank you, Governor. Thank you, Mr. Chairman.

Mr. TAUZIN. The gentleman's time has expired. The Chair recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and Governor, again, welcome to the Commerce Committee, and I appreciate the work of the Commission. Frankly, though, I think the Commission made some good recommendations. Some of the easy ones, though, the elimination of the 3 percent tax, I think we could all vote for that right now, whether it was the Spanish-American War or World War I. In fact, a member of the Commerce Committee, Representative

Klink from Pittsburgh, actually introduced a bill that would remove that tax last year sometime, and a number of her co-sponsors. I know there's a current piece of legislation, Congressman Matsui and someone else, has at the Ways and Means, so that's an easy one.

Extending the moratorium, I have some question because again, coming from Texas, and we had an exemption on that moratorium, I suggested our legislature in 1999 that we eliminate that, but there again, that's a local decision, so I would rather, instead of the Congress telling Texas what to do or telling Virginia on local taxes, that we let them do that and hopefully they'll—the powers that be will do it. I don't know about bold and innovative ideas that I heard, you know, because looking at the report, I think it made some good solutions and some of them that hopefully this Congress will pass.

The concern I have is, again, the State of Texas, I served from 1973 to 1993 in the legislature, and I was very well trained that some things need to be done in the local States and not here in Washington. Ten years before I got there, the State of Texas made a decision to have the sales tax as their basic revenue source and not an income tax. In fact, in the last 5 years, they put a prohibition against the income tax in the State constitution, that some of my Republican colleagues would like us to do.

What I see, though, as a Commission, though, is saying that we're not going to see a loss of sales tax revenue, and it will be the growth, and that's great, but I have a report from the University of Tennessee that shows Virginia by the year 2003 will see a loss of \$363 million. The State of Texas will lose \$1.7 billion. That agrees with my State controller, who is a Republican, has said that the State of Texas may lose a billion dollars in Internet sales.

I don't want to tax Internet service, and if I was in the legislature now, I would sponsor the bill to eliminate that, but I also know that we have some problem with States who traditionally use a sales tax as their revenue raiser. We don't have an alternative. We have a lottery, and again, we can't add another lottery to replace that one \$1.7 billion we may lose by 2003.

I know it goes back to the nexus rules, and that's what I wanted to talk to you about. Did the Commission talk about using the 1992 Supreme Court decision that if that using the nexus rules for, as we do now for mail order, to use for Internet sales? Is that something that the Commission discussed?

Governor GILMORE. The Commission, first of all, I believe that Congress suggested that catalog sales and Internet sales would be treated similarly, depending—and we should consider it as such, and of course, we have. With respect to the nexus standards, yes, there was the suggestion of this Commission is that the Congress codify nexus rules so that we understand what interstate commerce is really about. One thing I think the Commission adopted was the notion that interstate commerce is the purview of the Congress. I mean, that's obviously not stunning, but that nevertheless is what we concluded, that interstate commerce has to be addressed by the U.S. Congress under the Constitution. We no longer live under the Articles of Confederation, but I think—

Mr. GREEN. I don't know, maybe from our southern States we might have some disagreement there.

Governor GILMORE. We in Virginia have learned our lesson, Congressman.

Mr. GREEN. We were at the western end of that war.

Governor GILMORE. But we do live under a Constitution where the Congress is going to make the decision about interstate commerce. However, with respect to sales taxes within the respective States, I don't think there's any doubt about that, and there's no suggestion by anybody on the Commission that we ought to be trying to dictate matters intrastate within States. They can make those decisions, but when you're dealing with matters that touch upon a part and parcel of interstate commerce, and in fact, this isn't just interstate commerce. The Congress, I think, must recognize that this is really different. This isn't just interstate commerce. This is global commerce.

Mr. GREEN. And I understand that, though, to whatever we do within our own country, you know, I can order a book from the Cayman Islands, you know, that's not subject to the tax unless I happen to voluntarily pay it.

Let me—my time is almost up, but let me talk about another one of the concerns that I have is that the digitized content. I understand the weighing, the privacy issue versus the taxing and how local government or State government would have to get into that, but the suggestion on that is not only to exempt taxes on digitized content but also to expand it and the old fashioned nondigitized components, which include special taxes from books, music, electronic games, magazines, and even newspapers. I think it's ironic, again, looking at what my local State did, we long ago exempted sales tax on newspapers in the State of Texas. Obviously the newspaper lobby was very good, but we also liked not to pay sales tax on our news, except this last session of legislature extended the sales tax on newspapers only to airport facilities, obviously for those of us who travel through the State of Texas and want to buy a Houston Chronicle, we pay sales tax on it whereas if I go off the airport premises. So, I worry that again, we may be seeing—we may be dictating to the States on what may be part of the sales tax realm, and that decision really should be left up to those local States. Again, when you consider, particularly where I come from, of \$1.7 billion loss.

Again, before I lost all my time, could you address—you said that the Commission decided that the growth in sales would actually make up for that loss, and that's not something, at least our State controller in Texas or the University of Texas agrees with. Did the Commission have that information from the University of Tennessee study that—I guess it was released in February of this year, but also from State controllers around the country?

Governor GILMORE. I believe we did, and I believe that we listened to all ideas, including not only the Tennessee study but others, many other studies as well, that indicated that, in fact, that we were going to see a continuing growth of revenue as a result of all of this.

I think maybe the central point that I would address your question on is this. To the extent that we can maintain the growth of

revenues which, in fact, is the facts today and at the same time give working men and women around this country an opportunity to not pay taxes in certain forms of commerce which are different from traditional forms, and to grow this industry, but more importantly than that, to create a tax cut for working men and women across the country, the Commission believes that's a responsible policy.

Mr. TAUZIN. The gentleman's time has expired. The Chair wants to thank the gentleman, by the way, for supporting the repeal of that awful 3 percent excise tax. My mother's a Martinez. I'm not sure you know that, and we personally resent the notion we're still collecting money for a war against the Spanish.

Mr. GREEN. If I could respond, I agree, and like I said, our colleague on the committee introduced that bill last year, and I'm glad we're finally getting Ways and Means to get their attention. They don't let us do tax policy here.

Mr. TAUZIN. Maybe come together on this. Thank the gentleman. The Chair recognizes Mr. Shimkus for 5 minutes.

Mr. SHIMKUS. Thank you, Mr. Chairman. I think abstaining is kind of like kissing your sister, and to my colleague from California, had we had members who had the guts to cast a vote, maybe we would have had a majority or the two-thirds majority on some of these issues. I kind of find it appalling, a dereliction of duty, for the people to be named to a Commission that spend a lot of time and then abstain from a vote. I just want to—I applaud you bringing out the committee's report in such a manner.

I also have been always interested in taxation and how we hide taxes so the public really doesn't have an understanding of how much taxes we're paying and where it's going to. So, any way we can get to a clear, simplified process so that the citizens of our country, regardless of what level. I used to be a county treasurer. I used to be a local property tax collector. One of the most toughest, yeah, the Matthew of Madison County—but people scrutinize their property tax bills. They see the rate for the school districts. They see the rate for the municipality. They have a clear understanding. At least you can explain it. So, any way we can simplify the process and get rid of these taxes that are kind of pushing up revenues that the public doesn't understand I think is going to be helpful.

I'm most interested in the point seven of the report, Governor, that kind of addresses digital divide and the proposal to use TANF funds to help, I would assume, purchase computers, training for those who are most in need to help close the digital divide. Can you, based upon your experiences as the Chief Executive Officer of the Commonwealth of Virginia, explain how you would propose doing that given the latitude, based upon legislation? I'll listen for the response, and then if I have time, I have one follow-up on the same issue.

Governor GILMORE. Let me address several of the points that you have raised. No. 1, I believe the abstentions were a tactic, in fact, to prevent anyone from getting to the super majority. We just need to recognize that's what that was. Even on the digital divide proposals, which did rise to a two-thirds majority and to be a recommendation of this Commission, many of the Commissioners changed their votes in order to make that a super majority. Amaz-

ingly enough, the three Federal representatives did not. They remained in abstention on the digital divide proposal, which I find just astounding, considering that this is a forward looking approach, I think, by the Commission and it rose to a majority.

On the question of simplification, I think it's very important for me to mention to the members who are here, the simplification has two sides to that coin. Those that wish to impose taxes on the Internet seek simplification because they think that that is a way, a path to taxation. Others on the Commission, such as myself, support simplification because we just think it's in the best interest of the economy, the business community, and the men and women who are dealing within this new economy. So, we all believe that simplification is a good idea and that Congress should address that issue, but I want to emphasize that we have different goals in terms of that simplification and you should not be fooled by that.

Finally, the most important thing, as the Governor of a State, I think the digital divide, in closing, is very important, and I think we have opportunities here to be very creative and forward looking to partner with businesses to make Internet access available across the board. I have in my own legislature this time passed legislation which puts us in a position to utilize our libraries to make Internet access available, even if poorer communities. In fact, I wanted to go further and put them in community centers and use TANF funds.

We are very hopeful that the Congress will help us and the administration will help us to find TANF funds. We also hope that we can continue to extend this more and more broadly because access to the Internet should be as ubiquitous as the telephone, and if we do that, we are not abusing people of lesser means. We're helping them. At least if we apply a creative and progressive tax proposal such as the one that this Commission has come forward with in its majority proposal.

Mr. SHIMKUS. And I appreciate that, and I'll just follow up with I'm really intrigued by the use of TANF funds, and I would like to see, obviously, a computer and Internet access in every home in America, and I think that's how you improve education. That's how you're going to improve science and technology and mathematics, and so I think there's something we can work with.

Also, as important as lowering the taxation on the Internet access, which will be an issue that will help address the most needy in this new economy, and I yield back, Mr. Chairman. Thank you, Governor.

Governor GILMORE. Thank you, Congressman.

Mr. TAUZIN. I thank my friend for yielding. The Chair now recognizes the gentleman from Maryland, Mr. Wynn, for 5 minutes.

Mr. WYNN. Thank you, Mr. Chairman, and thank you, Governor Gilmore, for all your hard work on this project. I know it is not easy, and there are some very serious issues. I just have a couple of quick questions. As a Governor, can you share with us the position of the Governor's association with respect to the sales tax issue and whether or not we ought to have a uniform sales tax regime that will enable States to collect sales tax based on these remote sales?

Governor GILMORE. I think that the—it's clear that the National Governor's Association is on record as being more pro taxation in this area. There's no doubt about that. They do want to impose taxes. Each individual Governor must speak for himself, of course, and I think that each Governor is responsible for his position, and they should be held accountable for their positions, and that's okay with me, but NGA has taken its position and feels very strongly about it. Was there a second part of that question?

Mr. WYNN. Well, I just wanted to clarify. Do you agree or disagree with the notion of a uniform sales tax regime as the only way to address the sales tax issue with respect to cyberspace and Internet sales?

Governor GILMORE. Well, I don't believe that there's any necessity of imposing these kinds of taxes on the Internet, much less a uniform rate. If you go to simplification, which could take the form, I suppose, of one rate across the country, or maybe 50 rates or something of that nature, if you could get States to do that or localities to do that. Many localities in the States are home ruled localities and are not obligated to follow State rules in some of these matters, so I think it's going to be very difficult to reach that kind of simplification.

I want to repeat what I said a few moments ago, Congressman, and that is that simplification can take two forms, and Congress ought to understand this clearly. Some groups want to simplify, such as NGA, in order to reach taxation on the Internet. Some want to simplify simply to simplify in order help consumers and to help businesses and to help this new economy, and I am one of those.

Mr. WYNN. Okay, so you don't see that uniformity is necessary, is that your bottom line?

Governor GILMORE. Uniformity in this area?

Mr. WYNN. For sales tax collection by the States.

Governor GILMORE. On the Internet?

Mr. WYNN. On the Internet.

Governor GILMORE. No, I don't think that it's necessary.

Mr. WYNN. Okay. Do you then disagree with the Republican chairman of NGA, Mr. Leavitt, Governor Leavitt, excuse me, who seems to disagree with your report and seems to feel that there ought to be a vehicle for States to collect sales tax revenues?

Governor GILMORE. I do disagree, but I'm highly respectful of all the members of the Commission, including Governor Leavitt. He is a very strong advocate for his position. We're not in any type of emotional thing here. We're in just a situation of policy disagreement.

Mr. WYNN. My State, Maryland and its Governor is concerned about a possible loss of as much as 20 percent in the future of its sales tax base. I'm concerned, particularly when you have many States that don't have an income tax and rely solely on the sales tax as to how they can afford to exist in this kind of environment, and I'm concerned that the Commission has perhaps given short shrift to this concern.

Governor GILMORE. No, the Commission, in fact, dwelt on this concern, as a matter of fact. I think that the fundamental question is this. Should government get just everything it can get or should

it get what it needs. I think that the Commission did address the issue of whether or not an exemption on sales taxes on the Internet would necessarily lead to a reduction of revenue so as to reach that parade of horrors that I think has been raised—can't buy fire trucks and do those sorts of things. It was very thoroughly discussed, and I don't believe that the evidence supports that there will be a reduction in revenues. To the contrary, the evidence is that revenues will go up as cyber commerce goes up.

Mr. WYNN. Let me just jump in.

Governor GILMORE. Yes, sir.

Mr. WYNN. If there is a study to support that position, would you provide it to me, because it sounds as though there's a lot of speculation about State revenue losses, and it would seem to me that we ought to have something concrete one way or the other.

Let me move on because my time is passing. I'm sure you're familiar with the article by David Ignatius in the Washington Post where he refers to something called a Gateway giveaway. I would expect that you would have some concerns about that. I certainly do, and don't really understand why a tax break ought to be given, even though you actually have a brick and mortar operation. Could you explain your position on that?

Governor GILMORE. A couple of things. I think you're right that there's a great deal of speculation as to the horrible things that will happen if the people of American are not taxed. I think that's not right, and I think that we will provide—in fact, all of our information is on the Internet and available, and we'll provide you with all the evidence on both sides so that as a Congressman you can make up your mind.

Mr. WYNN. Is there a study on that issue, Governor?

Governor GILMORE. There are numerous studies on all of these issues, but the truth is, that there is very little evidence as to what the crystal ball is going to hold in the future because we really don't know how this industry is going to develop. Mr. Ignatius, I'm acquainted with him, but I think he is misinformed in this area. I don't believe that this is anything except an effort to provide good tax opportunities and breaks for the working men and women of this State, to have for the first time in history opportunity to engage in Internet commerce.

Mr. TAUZIN. Will the gentleman yield for a second?

Mr. WYNN. I'd certainly yield, Mr. Chairman.

Mr. TAUZIN. The gentleman was asking for a study. We do have one at the desk. It's by Robert Cline and Thomas Neubig of Ernst & Young Economics Consulting quantitative analysis, June 18. I would ask unanimous consent that it be made part of the record. The gentleman may have it.

Mr. WYNN. Certainly, Mr. Chairman, and if there are other studies, I think we need to get an authoritative analysis of the impact of sales tax or the loss of sales tax revenues on the State.

It seems to be a problem with revenues if you're exempting more goods from sales tax, and I can't understand why the suggestion is that that's not a problem for the States without going through, as you say, this parade of horrors. Certainly my Governor feels that there's a potential problem there.

Governor GILMORE. Congressman, again, we exempt goods and services all the time, at the Federal level, the State level, everywhere, that we make a policy decision we just don't want to tax. We do that all the time. The question, the material question is does it necessarily mean that we're going to see such a reduction in revenues as to make it impossible for States and localities to do what they have to do, and that, I think, there's no evidence that it's persuasive in that area.

Mr. WYNN. My concern is that we not shift the tax burden from the State level to the local level, the counties and municipalities so that they then have to raise their taxes. That's not really relieving the American taxpayer of a tax burden. It's just shifting it to a level of government that probably has less resources with which to cope. I would like you to respond to this Ignatius article and that Gateway giveaway, and also to the loophole for digitized content which seems to create a difference between a CD that is subject to taxation and a digitized version that's transmitted that would not be subject to taxation.

Governor GILMORE. The key question here is whether or not we can afford to give the people of America a tax break in the area of the Internet, and I think that we can, and that's the key. The key is not the idea here that somehow there is some effort by business people to enrich in themselves. These proposals go to the working men and women who pay the tax, who pay the tax, not to the business—

Mr. WYNN. I'm going to jump in because I'm sure my time is about gone, and just say this I don't want to—and I do respect your position. I don't want to have an ideological debate about tax or not tax. What I was trying to get at is the basis for making distinctions in what appear to be similar products and providing a tax break. I mean, whether we think taxes are good or bad is really not the issue. The question becomes why aren't similar items taxed similarly or why shouldn't they be taxed similarly, and then we'll get to the issue of whether they should be taxed at all.

Governor GILMORE. Well, again, the issue of whether or not you extend taxes into new areas of commerce is central to the thinking of the Commission and, in fact, this entire debate. With respect to certainly one of the discussions that we had is the question of whether or not localities or people in bricks and mortar stores draw, in fact, State services and therefore, people who go into those stores ought to pay that tax within that realm. On the other hand, those services are not necessarily drawn in the Internet area, and therefore there would be a rational policy basis for making that kind of distinction. All this was, of course, discussed in the Commission.

Mr. TAUZIN. The gentleman's time has expired.

Mr. WYNN. Thank you, Mr. Chairman.

Mr. TAUZIN. The Chair thanks the gentleman. The Chair now recognizes the gentleman from New York, Mr. Fossella, for 5 minutes.

Mr. FOSSELLA. Thank you, Mr. Chairman, and welcome Governor Gilmore. I applaud your efforts in the Advisory Commission, and I think the American people should know that they have someone

who is pro economic growth and pro taxpayer who has chaired it, so I commend you for your efforts.

I guess just listening to the debate and watching it from afar, I get the sense that there are so many people in government who are just fascinated with what's happened in the Internet, the revolutionary changes that have come across as a result of that medium, and the economic growth continues to meet new heights. I guess they're fascinated because they had nothing to do with it, and now they want to get their greedy mitts over all this money that they see as an opportunity cost, when in reality, Governor, and correct me if I'm wrong, the National Governor's Association collected \$11.3 billion in tax surpluses in 1998, despite tax cuts totaling \$5.3 billion in 1998 and \$4.9 billion in 1997. An end of year balance for all States total \$35 billion by the end of 1998. In 1999, the States took in \$7.5 billion in tax surpluses, despite additional tax cuts totaling \$7 billion. Sales tax in particular continued to increase in both 1998 and 1999, and the States collectively took in surpluses of sales tax totaling \$2.3 billion in 1998 and 1999—\$2.2 billion in 1999. Is any of that not true, Governor?

Governor GILMORE. Congressman, it's all true, and I think it's good to the central point here, and that is if there are sufficient revenues coming in and growing, as a matter of fact, so that States and localities are awash in funds, why is it that the people of the United States can't get a tax break in a particular area? In fact, they don't pay those taxes now for the most part except the use tax obligations, and I might say that the States have imposed use taxes, which is a substitute for the sales tax, and they're basically asking people to sort of mail it in, but a lot of people don't. I think we ought to decriminalize the people of the United States and get rid of that use tax, but that's not a part of the Commission suggestions.

Mr. FOSSELLA. Well, thank you for that, and confirming what to be true. Just a couple of days ago, for example, in New York, the State assembly and Senate and the Governor compromised on a budget deal that acknowledged that this year alone, the State of New York taxpayers have generated a more than a billion dollar budget surplus, so I'm befuddled as to why those who see budget surpluses across the country now want to step in and really stop the economic engine that's driving much of this Nation, both here and abroad.

Let me give you an illustration, Governor, and for those who might be interested. Staten Island, who I proudly represent, has an 8.25 percent sales tax imposed on clothing, State tax and city tax. We lose about a billion dollars in economic activity to nearby New Jersey that does not impose a sales tax. A couple of years ago, those of us who push for just 1 week of sales tax free week to give some relief to Staten Islanders who wanted to stay on Staten Island, not pay that 8.25 percent tax. People spoke with their feet. You know, human nature and economics 101 worked. In that 1 week alone, sales increased by over 100 percent in the stores in Staten Island. I think that's a reflection of what the American people want, less taxes, not more. If those Governors and those people around the country want to look to the Internet to tax, to compensate for their high tax structure, I suggest that they cut the

taxes that already exist and promote economic growth. So, if you can just carry that back to your other members and your colleagues on the NGA.

Let me just leave you with a couple of questions, Governor. Just curious, I know it takes a lot to tango here. What position, if any, did the Clinton-Gore Administration take on the Commission, especially with regards to consumer privacy? You touched upon it before. Is there any other evidence that an imposition of sales tax on the Internet will stunt the growth of E commerce, and finally, the international tariffs and taxes on E commerce present a threat to U.S. global competitiveness?

Governor GILMORE. The three Clinton-Gore Administration representatives joined the pro-tax block and never deviated. I think if they were prepared to work with us in order to try to craft a super consensus on a pro-taxpayer position, we would have known it. There was never any evidence of that. Even in the closing days when we were reaching for further discussions in order to try to bring them around, they never came, and there was an abstention throughout on any type of pro-taxpayer positions that were taken. Amazingly enough, even on the privacy position, an abstention, which I thought was astounding.

Mr. FOSSELLA. And as much as that this is a global theater we're playing in these days, the international tariffs or taxes on E commerce present a threat to U.S. global competitiveness?

Governor GILMORE. It produced an opportunity for us. We are dominant in the world today because of the growth of this industry. It is a big advantage to the United States, and I think we ought—the Commission believed that we ought to continue to find ways to eliminate tariffs in order to be able to provide the greatest possible opportunities to the people of the United States and of the world. I know the European union would like to impose these taxes. The European union are experts in imposing taxes, but Americans, I think, are more forward looking, and I think that we will try to find ways through international negotiations to try to eliminate these taxes, especially on E commerce originating in the United States.

Mr. TAUZIN. Then gentleman has just 30 seconds left. Would he like to—

Mr. FOSSELLA. I just have one more question, then I yield, if I can, Mr. Chairman. That is, I think it's important, if you can, Governor. You talked about tax simplification as almost a code word. If you can elaborate on that slightly and whether it's—how it's sort of correlated to the Quill decision of the Supreme Court, and you brought up how it's a code word to try to merely increase taxes when in reality—Okay.

Governor GILMORE. The law today is that remote sellers cannot be required to collect those taxes under the Quill decision. I think that the pro-tax folks believe that if we can go to a simplification type of approach, then you can find a way to overpower that court case and, in fact, impose those taxes. So, we have to be careful because simplification has become a code word for increasing taxes. I don't think it has to be that way, and the folks who are not for taxation also believe that there should be simplification, but not for the purpose of trying to overturn Quill or to impose a tax regime,

but just simply because it's good for the businesses, entrepreneurs and consuming men and women of this country.

Mr. TAUZIN. The Chair is now faced with two unanimous consent requests that I want to try to honor. Mr. Wynn has one and you had one first. If Mr. Wynn will cooperate with me, let me take care of this one, then I'll recognize—

Mr. FOSSELLA. Mr. Chairman, if I might just yield 30 seconds—

Mr. TAUZIN. The gentleman has unanimous consent to yield 30 seconds of time to one of the subcommittee chairman who is not a member of the subcommittee but wishes to address the point that he is the author of with reference to Internet access taxes, I think. Mr. Upton, without objection, it is so ordered.

Mr. UPTON. Well, thank you very much. I appreciate the gentleman's indulgence. I just want to say, and I appreciate your comments this morning, your leadership on this issue. I would note that, though I'm a taxpayer and a voter in Michigan, I'm also a taxpayer in Virginia, so your efforts to lower property taxes would be good, continued efforts to do that.

Just one thing. As I read and sign all of my legislative mail, there has not been an issue that has generated more interest back home than the possibility of the FCC allowing for access fees or charges to Internet use. I've introduced legislation that's bipartisan. Many of the members of this committee and subcommittee, in fact, are co-sponsors, and I appreciate your comments as part of your statement in support of my bill that would block that FCC allowed access charge, and I am working with Chairman Tauzin and Bliley to get that bill moving, not only in the House but also the Senate. I yield back the balance of my time.

Mr. TAUZIN. I thank the gentleman for his statement. The Chair would recognize the gentleman from Maryland for a UC request.

Mr. WYNN. Thank you, Mr. Chairman. Earlier in the proceeding, you entered into the record a report on the subject of Internet taxation and impact on the sales tax entitled *The Sky is Not Falling*, why State and local revenues were not significantly impacted by the Internet in 1998. I just wanted to flag that document and note for the record that this study was prepared for the E commerce coalition of broad based national coalition dedicated to providing sound policy information on taxation of electronic commerce. The coalition members include America Online, Incorporated and its consulting Cisco Systems, First Data Corporation, Intuit, Microsoft Corporation, Time-Warner, Inc. and WalMart Stores.

Mr. TAUZIN. Without objection, that is so noted.

Mr. WYNN. Thank you, Mr. Chairman.

Mr. TAUZIN. The Chair now recognizes the gentleman from Ohio, Mr. Sawyer, for 5 minutes.

Mr. SAWYER. Thank you, Mr. Chairman, and Governor, thank you for your testimony here today and all of the hard work by you and your colleagues that preceded it and for the additional comments that you've brought here today.

We've touched briefly on several occasions on the international consequences of the work of the Commission and the policy decisions that remain in front of us. In fact, points 10 and 11 of your testimony deal directly with that. They speak in policy terms, large

principles. I was wondering if you could share with the members of the committee the specifics of—let me give you one example. We're talking about taxation in terms of imposed taxation, but at the same time, we're talking about trying to create a neutrality with regard to other forms of taxation—the European Union, for example, with the widespread use of embedded taxes through the value added tax. Could you explain to us how the principles that you're talking about, particularly in point 11, would apply in the case of embedded taxes like the European VAT?

Governor GILMORE. It's a complicated question. Let me see. With respect to international tax and tariff issues, there is a sense that we would like to see, according to the suggestions of the Commission, to the greatest extent possible, not having taxes and tariffs be charged on Internet goods, services, and so on that are being transferred from country to country. To the greatest extent possible, we would like to free the Internet from tariffs, and that is I think the point the Commission has made.

Mr. SAWYER. I understand the—I fully understand the policy. It's the one that we, this committee, and others have spoken to internally within the United States, but almost all of our taxation, at least in terms of the way in which it deals with goods and services that might be either transmitted over the net or in fact, commerce that takes place through the net, even if it's in real goods and services, those largely involve super-imposed taxation.

Governor GILMORE. VAT taxes, for example?

Mr. SAWYER. Pardon me?

Governor GILMORE. VAT taxes you mean?

Mr. SAWYER. Oh, no, no, no, sales taxes, as opposed to VAT taxes, whose costs are embedded throughout the process of getting it from raw material to the point of sale. How do you desegregate all of that in ways that would carry out the principle that you've clearly announced here?

Governor GILMORE. I think the Commission felt that to the greatest extent possible, we ought not to be opposing additional tariffs, either on goods coming in or going out, digital goods, transmissions particularly, with respect to keeping that free flow of that kind of communication back and forth.

Mr. SAWYER. Did the Commission have any direct conversation with representatives of the European Union or other major global taxation regimes that—

Governor GILMORE. Yes, there were, in fact, representatives from the European Union who came forward to the Commission and addressed their point of view. We also had a representative of the International Trade representative on the Commission.

Mr. SAWYER. Would it be possible to share written materials regarding those conversations so that we might better understand how the policies or the principles that you've announced here would apply in the real world?

Governor GILMORE. Certainly, and it gives me the opportunity once again to state that this is a year in which we have seen everything. We have heard everything. We have listened to every one, and all of it has been made very, very public, both on the Internet and otherwise. I'll be happy to pick out these materials and send them to you directly.

Mr. SAWYER. I very much appreciate that. Thank you for your time today on that. Let me ask one further question. In the Ignatius article, he points out the notion that some items, for example, books, music, electronic games, magazines and software, that can be digitized. There's a clear intent to avoid taxation on that, and in order to create a level playing field, he suggests that you are proposing a migration on the real world brick and mortar taxation on any goods of that kind that could be digitized in order to create a level playing field. Does he accurately represent the recommendations of the Commission with regard to that?

Governor GILMORE. I think that Mr. Ignatius came at this from a point of view, and I don't have the article in front of me. I just remember it when I saw it. I think his point of view was gee, this is some type of grab. I think that's what—

Mr. SAWYER. I'm not arguing that.

Governor GILMORE. You're not arguing that.

Mr. SAWYER. I'm not arguing.

Governor GILMORE. I believe that—

Mr. SAWYER. Mr. Chairman, I realize that my time has run out. If I might have unanimous consent just to read a very brief paragraph.

Mr. TAUZIN. Without objection, the gentleman may have that.

Mr. SAWYER. Because you don't have it in front of you, and that's not fair. A new loophole to exempt from taxes all digitized content, things that can be sent electronically, such as music, E books, on-line games, and software, and their old fashioned, nondigitized counterparts. In other words, the Commission would create a special tax exemption for books, music, electronic games, magazines and software sold in the brick and mortar world. Is that the intent of the Commission?

Governor GILMORE. The Commission, in fact, made that a part of its report, and that is correct. I think that certainly from many of the members' points of view it is just this. If we can find an opportunity to extend a tax break to the people of the United States in an area that does not then impinge upon the necessary revenues of the States or localities to do their jobs, then we ought to extend those tax breaks. I mean, you can always, of course, take the position that government can take every dime that it can get its hands on and spend it, but—

Mr. SAWYER. Obviously I don't take that position.

Governor GILMORE. Obviously we don't take that position. I think the approach is instead, is it possible to extend further benefits by way of tax breaks to the people of the United States, and I think the Commission came down and concluded that if it is possible to do that, it would be good policy.

Mr. SAWYER. I understand the position you've taken. Thank you very much, Governor.

Governor GILMORE. Thank you.

Mr. TAUZIN. Thank the gentleman. The Chair is now pleased to recognize the ever patient, ever cheerful, most lovely, the gentlelady from Wyoming, Ms. Cubin.

Ms. CUBIN. Thank you, Mr.—

Mr. TAUZIN. You know what I'm doing here. I'm trying to make up for calling on you so late here, Ms. Cubin.

Ms. CUBIN. It's okay. I've enjoyed the discourse. Welcome to your, Governor Gilmore. I, too, am a property owner in Virginia and appreciate your attempt to reduce property taxes.

I must express my disdain for those members of the Commission who abstained instead of voting one way or another. I can't help but wonder if they were too cowardly to show that they really wanted to increase taxes or if they were too uninformed to make a decision or if they simply were unprepared to do that, and heaven forbid that it could possibly be a political thing that they did in abstaining, but I do want to thank you for the work that you did and for the intellectual integrity that you demonstrated and that other members of the Commission demonstrated as well.

I have but one question because I know that you really do need to get going. One of the recommendations that the Commission's report encourages is for localities to simplify their sales tax and use taxes in order to create fairness and parity in Internet sales tax and the traditional brick and mortar sales taxes. I just wondered if you have any idea how close or if States and localities are moving in that direction or if this is yet uncharted territory?

Governor GILMORE. No. I think that there has not been a track record or simplification. This Commission recognized that point and suggested that there ought to be incentives for, in fact, simplifications, but I want to point out that there may be legal impediments to simplification. Again, as I said, many localities exist in home rule type of environments where they have the authority to make these kinds of decisions instead of taking orders from their State governments.

Constitutional provisions provide, make it very difficult for simplification as well. The sense of the Commission of simplification is a good idea, though, but not necessarily, and again, we fought pretty hard as to whether or not there was going to be a statement that simplification should automatically lead to taxes. That was fought out in this Commission and rejected. Simplification is a good idea, but not necessarily as a path to further taxation.

Ms. CUBIN. Yes, I certainly would agree with that. I know also that even within States, different counties have different levels of sales tax and different ways of collecting them. Thank you very much, and thank you for your work.

Governor GILMORE. Thank you, Congresswoman. That's why it's going to be very difficult, I think, to create a technological method without invading everybody's private information, which I think that the Commission doesn't think's a good idea.

Ms. CUBIN. Thank you, Governor.

Mr. TAUZIN. Next, the gentlelady from Missouri. Ms. McCarthy is recognized for 5 minutes.

Ms. MCCARTHY. Thank you very much, Mr. Chairman. I apologize for not being here for the full testimony. Governor, I very much welcome your input today, and I wanted to pursue a conversation I had yesterday with Bill Gates in a meeting, who was very kind to come to the Capitol and meet with many of us concerned about many issues regarding the Internet but in particular, the taxation of the Internet.

His comment to me was that we should encourage States to collect the use tax, and that would address the matter. You are a Gov-

error. You know how difficult it is for States to collect the use taxes, and in a State like my own, Missouri, are voluntary. Consumers are supposed to, when they send their taxes in, also send in the taxes they owe on those purchases made by catalogs, historically, or out of State sales in some form or another, particularly if there is nexus in the State.

I just now got a glance at resolution No. 5 in your report. So, I wondered if you'd please comment on the recommendation of resolution No. 5 that prohibits sales and use tax on remote sales of goods and services to individual consumers and prohibits taxation of sales of digitized goods and products purchased by individual consumers electronically over the Internet. How is a State then to cope with the loss of this use tax, which for Missouri would be about \$395 million annually, if I'm understanding the underlining here by my staff correctly, would prohibit the collection of it or the application of it for sale of goods and services to individual consumers.

Governor GILMORE. Again, I'm not sure what you're reading from because the discussion of the use tax is not going to be a part of the final report. I wanted to actually have a discussion of the use tax but didn't put it forward at the end. However, I do have made, addressed that in my separate proposal, and I think I'm the only one that did, in my separate filing that I'm doing within this report.

Virginia has a bi-annual budget of \$48 billion, and I have felt that the right policy would be to eliminate the use tax for people—for people. So, you have to compare apples and oranges here. The use tax, of course, can also be applied business to business, which is the far bulk of what E commerce is today. I'm in this to try to help working men and women of America, so I believe that we probably ought to eliminate the use tax, business to consumer.

In Virginia, our bi-annual business is \$48 billion. I've asked our treasury how much money are we collecting every year business to consumer use tax, and the answer is less than a million dollars a year, out of \$48 billion over a 2-year budget. So, it isn't much money that the States would be doing without, frankly, to eliminate the tax, business to consumer, on the use tax. I might say that it is very difficult to collect. There is no good systemic approach. There is no technological approach that doesn't invade people's privacies. People don't pay the tax to their States, and they're all criminals. I think it's time to de-criminalize the people of the United States and to eliminate this business to consumer use tax, but that was not addressed in this Commission report.

Ms. MCCARTHY. I think what I am reading from, in fact, is your own personal comments submitted, so it was not part of whatever—

Governor GILMORE. Well, I stand by that. It's going to be in the report, but it's my individual submission. I say again, that every Commissioner has an opportunity to file one of those with their own personal views.

Ms. MCCARTHY. Well, I understand your thoughts on the current application of the use tax in the States. It is not well collected or remitted. I don't have the Missouri numbers at hand, but I know

the potential for Missouri is \$395 million if, in fact, it were remitted and collected.

Governor GILMORE. And that's all taxes—business to business and business to consumer, probably because that's—

Ms. MCCARTHY. Yes, I think that's it.

Governor GILMORE. That's probably everything.

Ms. MCCARTHY. And in Virginia, it would be about \$364 million. I'm raising this because in the area of taxation, I am very concerned about the mom and pop retailers who keep our main streets and our communities thriving in Virginia and Missouri and all over this country. There didn't seem to me in the context of your Commission a presence of the brick and mortar businesses that are small mom and pop retailers established in our communities all across the country, and they do collect and remit sales tax to the States, and that collection, remittance of State and city and county sales taxes is the lifeblood of those governing bodies, and you are well of this as Governor. It's something that they must, in fact, depend upon. Do you recommend in your Commission report that absent those mom and pop retailers, who will, unless they find out some new creative way to make their sales other than locally on main street, you know, where they're paying property taxes for the schools and, you know, they're remitting to the State the employment taxes and so forth, if they go away go under or go on to the net, what taxing tools you are going to offer States, cities and counties so that they may continue to do the job they must do?

Governor GILMORE. Let me answer you most directly. No. 1, everybody was represented on this Commission. I mean, every point of view was represented on this Commission, and everybody had a chance to have a representative strongly take their position and furthermore, everybody had a chance to come before this Commission, no matter whether they agree with any particular member or not.

Second of all, I think that one of the great myths that is put out is that is mom and pop small businesses are going to be hurt by a no tax proposal and therefore we have to impose taxes on the customers, and that's just nonsense. The fact of the matter is that small business, for the very first time in history, have a chance to go beyond the front door of their store in that limited marketplace and now extend themselves out over the net and compete with the big businesses and capital intensive organizations that can afford to do that. So really, this is not a proposal that is bad for mom and pop businesses. It is, in fact, good for mom and pop businesses who have an opportunity to trade in that way.

Finally, the most important point is this. If we go ahead and put tax obligations on to the mom and pop stores, it's harder for them because they're smaller, to collect and to remit and to keep track and to file, and that is the goal here. The goal here by elimination of those taxes—in fact, it's going to be a big, super benefit to mom and pop stores.

Ms. MCCARTHY. I would like to go back to my conversation with Mr. Gates and disagree with you. He's quite convinced that with the technology at hand, collecting the use tax is going to be relatively easy and painless for anyone—individual working out of their home with an Internet or a mom and pop store. I think he's

got more wisdom—I know he has more wisdom than I do on the technology, but I've got to think, even from my limited experience as a visiting Silicon Valley a few times that there's somebody somewhere there 23 years old that will stay up all night and come up with a program needed to do this.

I think this debate started in this very subcommittee because I raised the issues of tax fairness and I remember it well talking to Mr. Cox that day when he first presented the bill and saying you know, have you talked to the States, the Governors, the counties, et cetera, because the sales tax is their life blood. They've got a whole lot of commitments to the people they serve locally to carry out things we don't expect to do at the Federal level, and as a result, your Commission was created, and it's a very good Commission and a very good vehicle and a very thoughtful process and 2 years of hard work, but I don't see an answer yet, and I hope the report will address it thoughtfully that says here's what we're going to do. We're going to give the States alternative taxing mechanisms or we're going to somehow try to level this playing field. I lived through, as a State legislature, the last time we shut down main streets all over America when we came in and provided the tax incentives for the shopping malls and the WalMarts to build right outside of town, and I watched those hardware stores close and those little dress shops all up and down main streets all over Missouri, and I don't want to go back there.

Governor GILMORE. Right, I agree, and that's in fact the point of the Commission, as a matter of fact. For the first time in history, the small guys get a chance to compete on an equal basis with the big guys. We finally have an opportunity to do that if we just don't blow this. By the way, nobody is suggesting the elimination of the sales tax anywhere. This is a question of whether or not sales tax is extended into a new and similar form of commerce and whether that will have dire consequences, and the Commission just didn't find them.

Ms. MCCARTHY. Mr. Chairman, I hope that our subcommittee grapples with this particular issue a little bit further in the future. I don't want to delay the committee's work today, but I have a feeling when we visit again on this in the future and we revisit your thoughts on it, we'll have better information to know just where we're going. I would hope that's what the Commission would have provided us, but maybe we as a subcommittee, Mr. Chairman, must resolve that on our own. Thank you.

Mr. TAUZIN. Thank the gentlelady. The Chair would like to observe that he, too, can comment as to who has more wisdom, you or Bill Gates, but at least you're not in the middle of a big lawsuit.

The Chair recognizes the gentleman from California, Mr. Cox.

Mr. COX. Governor Gilmore, I think the topic currently under discussion is worth pursuing. It really did animate our discussions at the time that Ron Wyden and I were first pioneering the Internet Tax Freedom Act. I will point out that a handful of Governors, our Governor in California, Pete Wilson, and first Governor Allen and then Governor Gilmore in Virginia, were among just a handful of that Nation's Governors early on to see the wisdom of permanently banning discriminatory taxes on the Internet. That's really what we're talking about, I think.

The Internet Tax Freedom Act, which created the Commission and also banned these taxes, as you point out, didn't come close to banning sales taxes in America. To the contrary. It's my understanding, and I want to ask you about the Commission's findings on this point, not just your formerly voted upon findings but the research work that you did preparatory to making your recommendations. It's my understanding that tax collections to State and local governments from the sales tax during the period of time that the Internet economy and E commerce have exploded have gone up, not down. That, in fact, we have record sales tax collections. That's our experience I know in California, and I wonder if that's what you found in looking at this as a national problem.

Governor GILMORE. That is correct, Congressman Cox. The growth of the industry is different. It's exciting. It's an opportunity. Revenues, in fact, are going up, not down. Now, my goal in life is to try to have the people of the United States share in this, and that means that if we could give them an opportunity to do business and to have their opportunity as individual working men and women to participate in the Internet without taxes, it's a benefit to the people of the United States and we should be loath to pass it up.

Mr. COX. How about this issue of businesses on Main Street being put at a disadvantage by the Internet? The premise of that argument is that we've got the bricks and mortar economy over here. We've got the new cyberspace economy over here, and the new economy is eating up the old one. My experience, again, in California which may not be typical, which is why I want to address this to you as the chairman of this national Commission, is that we have rather rapidly over the last few years moved away from that stark division of E commerce on the one hand, bricks and mortar on the other, to what might be called bricks and clicks, that people with long established retail businesses are taking full advantage of E commerce, that people with long established wholesale businesses are starting to conduct their business to business work that way. It is not a displacement of one with the other, but rather Main Street is now reaching new markets that they couldn't reach before. They're not limited to the people who live within a three mile radius of their storefront. They can reach people in Japan or in Finland. Is that what you have seen?

Governor GILMORE. Yes. We have, of course, an example we use over and over again of a company that deals in agriculture, sells peanuts basically, at a local place off of the road in a remote area. Now they're selling these gourmet peanuts to the entire world. They have opened up their market, and they have opportunities. Clicks and mortar is going to be more and more the rule, and it's an opportunity, not a problem, for small business.

Mr. COX. Governor Gilmore, you've been very kind to take my additional questions. The Chairman was kind enough to yield me the opening round, and I want to yield the entirety of the balance of my time in the next round as well to the Chairman.

Mr. TAUZIN. I thank the gentleman. Governor Gilmore, you pointed out in your report to us that taxation of telephones, which are one of the carriers of the Internet, does amount to a tax on the Internet, in effect. I was privileged to read a report not long ago—

I think I sent you a copy—by Progress and Freedom Foundation that indicates that taxes on telephones have gone up as much as 62 percent in the last 12 years, indicating an extraordinary explosion of taxes that directly impact the Internet. In fact, there are some jurisdictions in America where there are more taxes on telephone usage in America than there is on tobacco, which is a rather extraordinary thought in a free speech society.

Is it your personal view, and did the Commission in whatever majority, super majority, whatever form it took, did the Commission feel, as I do, that this load of taxes on the carriers of the Internet, amount to a form of Internet taxation that we ought to seriously look at reducing?

Governor GILMORE. Yes. I think that the Commission, certainly on its 3 percent excise tax, addressed that issue and pointed out that these kinds of burdens on access weigh particularly heavy on people who have lesser means, who sometimes can't get telephone or they have a hard time paying for the extra dedicated line for the Internet because of the additional taxes. So, any reduction in tax is a liberation to the people of the United States for the use of the Internet.

Mr. TAUZIN. Now, I think I know the answer to this because you and I talked about it, but as I understand, the Commission did not get into the question of whether or not there is an unequal tax treatment, depending upon what Internet service people are buying. That is, if I'm buying my service through a cable company or I happen to buy it through a satellite or terrestrial wireless company, I might pay less taxes on that Internet service because those carriers pay less taxes than the telephone company is required to collect from me and pay to various local and State and Federal Governments, isn't that correct?

Governor GILMORE. Yes, but I think again, the Commission did not fully address the alternative forms, other than to point out that to the greatest extent possible, we should reduce costs so that more people have access to the Internet.

Mr. TAUZIN. And you did, indeed, focus on the question of access to the Internet, that apparently you spent a lot of time thinking and talking about generally about the importance of this phenomena, the Internet, to the success of families, of working men and women and their children and their families, in this new society. You put a great emphasis on making sure everyone had access to it. I want to, first of all, commend one of your communities in Virginia, Blacksburg, Virginia, which was I believe the first community in America which decided to become a totally Internet wired up town, all connected to the University of Virginia Tech's intranet system, something we're trying to replicate in my own State now.

The notion of everyone connected, everyone a part of the Internet is obviously pretty strong in your report. I wanted to take it the next step. We're beginning to see the deployment and the rapid expansion of Internet capabilities under high speed of broad band Internet services, and I wonder if the Commission spent any time at all differentiating between the old Internet services and the new broadband services that are going to make a lot of difference in terms of whether the small mom and pop business will be able to

compete in the high speed, broad band world, or did you not even get into those issues?

Governor GILMORE. No, I think we did not address those issues, Mr. Chairman.

Mr. TAUZIN. If I can make sort of a point there that I would hope, as you go forward and finalized your own comments on this, that the point you made with Mr. Cox about the Internet becoming a vehicle by which small, competitive businesses can become competitive with the biggest businesses anywhere in the world because of the Internet, that point becomes almost moot in a broad band world, where if the only service that small community has and the only service that small business has, is the old Internet, the old simple Internet, rather than the broad band, high speed Internet that's going to make literally an entirely new world of economic opportunity available to them. It is going to make a big difference as to whether or not—whether we tax or not tax those small businesses have the opportunities you discussed with Mr. McCarthy, and I just want to put on the record, because it's an issue that I'm very close to and pushing very hard in this Congress, that access to broad band services will perhaps be even more important than access to the old Internet services. I would just like to highlight that in connection with the emphasis you have put on the need to have access to all of the folks in your community.

The gentleman's time has expired. The Chair will now recognize the gentlelady, the—

Governor GILMORE. Mr. Chairman, may I ask for a 3-minute recess, please?

Mr. TAUZIN. Yes. I'm sorry. The Chair will declare a 3-minute recess, and we'll return in 3 minutes.

Governor GILMORE. Thank you.

[Brief recess.]

Mr. TAUZIN. The Chair will declare this subcommittee back in session.

Governor GILMORE. Mr. Chairman, thank you. There are some issues the Internet can't address. I appreciate that.

Mr. TAUZIN. Well, you were signing bills, I know, and we wanted to accommodate you.

We now recognize the gentlelady, Ms. Wilson, from New Mexico.

Ms. WILSON. Thank you, Mr. Chairman. Governor Gilmore, I found your testimony to be refreshing and your answers to questions to be refreshing in looking to the new economy and the benefits that it brings to America, particularly the statement that the Internet changes everything, including government. It's certainly changing things around here. I don't know if this hearing is streaming across the Internet, but they often do from the Commerce Committee, and I'm now finding in my office that I get more electronic mail than I get snail mail, that we're doing more constituent services on the Internet and providing more information on the Internet to constituents.

We've gone from vote.com to direct input on pending votes from my constituents on our web site, and it is completely bilingual so that you can toggle back and forth between English and Spanish and provide that kind of direct constituent service to people.

I also take your point about getting beyond the front door for little companies, whether it's Bueno Foods for those of you who just can't yet get your green chili fix on the east coast, you can log on and buy it directly on the Internet.

I have a couple of questions for you based on your experience as a Governor. You talked in your testimony about the Virginia Diner, and you talked briefly about it in the answer to someone else's question. When you talk to folks in Wakefield, Virginia about the success of VaDiner.com and the can of peanuts that they may sell for \$1, when you go down the street to the Stuckey's and talk to them about the fact that they have to charge \$1.06 or \$1.05 for that same can of peanuts, how do you explain it to the folks who aren't yet part of that new economy? How do you answer the fairness question?

Governor GILMORE. Well, I think that you answer it this way. I think you ask yourself the question, is there an opportunity, in fact, for Stuckey's to go online, for them to open up and do something entirely different and to, in fact, go online and become sellers themselves, and of course the answer is that there are. From the government's point of view, you have an opportunity here for new jobs to be created in the Internet economy. The Virginia Diner example, for example, there are new people that are now being employed. They're going to be paying income taxes, so those kinds of funds are there.

In terms of a fairness issue, the question is really what's fair to the people of the United States. Isn't there an opportunity here for them to make purchases and to have those changes to do that without paying taxes?

Ms. WILSON. I guess the only other question that I'll ask you and then I'll yield the balance of my time is we've seen explosive growth in the Internet, but it's still a fairly small percentage of our economy and most of the Internet sales is still business to business as opposed to business to consumer. If you look at where we're going to be 5 or 10 or 15 years from now, it may be a much more significant percentage of our economy. How, as a Governor of a State do you see your revenue streams changing from a way—you have sales tax as well as income tax.

Governor GILMORE. We do.

Ms. WILSON. I understand you may not have car tax anymore, the property taxes. How do you see your income streams changing, and how, if you were the Governor 10 or 15 years from now, would it look different than it is today?

Governor GILMORE. I think nobody has a crystal ball, so it's impossible to speculate. There are many people today that are asserting that the growth of E commerce is going to destroy other things around it, and there just isn't the facts to sustain that or to substantiate that. The question is, is the sales tax going to be diminished? There's no evidence that it is. Is there an opportunity to reach for more revenues? Certainly, and you could perhaps reach into that area and get additional revenues, but the question is what revenues do you need and are they going to be diminished? Right now the evidence is not there to show that the sales tax is going to be diminished in Virginia or anywhere else in America.

Ms. WILSON. Thank you, Mr. Chairman. I yield my time.

Mr. TAUZIN. The gentlelady's time is expired. The gentleman from Mississippi, Mr. Pickering, is recognized for 5 minutes.

Mr. PICKERING. Mr. Chairman, thank you. Governor Gilmore, my question or line of questions starts with the moratorium under your recommendation is extended 5 years to October, 2006, is that correct?

Governor GILMORE. I believe that that is, in fact, what the proposal will be, yes, sir.

Mr. PICKERING. Do you think that there's anytime during that process or at the end of that moratorium, should we re-assess, should we look at how the conditions, how the market, how the technology, is affecting commerce, both main street and electronically, to make a decision at some point in the future whether there should be some type of uniform tax, or should the Internet effort come under a tax. Is it your position that it should be tax free forever?

Governor GILMORE. While I believe that was probably the best policy, we debated and questioned both privately and also in public among small groups and larger groups as to what the proper approach ought to be. There are many people that believe that the moratorium ought to be permanent. I believe that this proposal will come forward and suggest and 5 year extension. Then of course, it would be very reasonable at the end of that 5 years to take a second look at see where we are.

Mr. PICKERING. You had mentioned in your other comments about a business to consumer use tax and doing away with that. What are the consequences or what would the consequences of doing away with the business to consumer? We're seeing great advantage of business to business E commerce. If you did do away with the business to consumer use tax, what are those ramifications?

Governor GILMORE. None, except for the fact that individual working people wouldn't have to necessarily pay the use tax, and if they don't think to do it or don't do it because it's unenforceable, they're not criminals anymore. There's no reason why a State or the United States couldn't adopt a policy that says that you still do have the use tax on business to business, which at this point is the biggest bulk of the Internet commerce that is going on.

You see, the practical reason is this. There are two things that I want to say in response to this. The first is that you can technically collect a business to business use tax. You can do that. By routine audits and that type of approach, you can do that. You technically can't collect the use tax over the Internet because the privacy and the technological ability to do it just isn't there, just isn't there.

The second point is this. My goal is to do something good for the people of the United States, for the citizens of the United States, not necessarily just the businesses of the United States, although certainly commerce and opportunities for people to grow as the American economy grows, but this is a chance for people to have a chance to have—not to have to pay that use tax. So, my emphasis, again, there wasn't much discussion of the use tax in this Commission. I would like to have raised it, but just declined to do that because I thought that the other approaches that we had were so

material and so helpful to the Congress that we would address the use—I would have wanted to address the use tax individually myself, and that's what I did.

My goal here would be to eliminate the use tax from business to consumer because it helps people, especially people of modest means.

Mr. PICKERING. Has anyone ever quantified or tried to quantify the business to consumer use tax?

Governor GILMORE. In Virginia I did. As I said, I asked my folks, I said what is it that we're going to miss if we abolish this? What is it we're getting that we'd be doing without. The answer is less than a million dollars a year on a bi-annual budget of \$48 billion, \$48,000 million, if you will. So, it's not very much money. So, the question really is this. Does government have an opportunity here to give a really good tax cut to people and to release them from a legal obligation that criminalizes them when they don't pay it, and to do a real benefit just for working men and women across this country and for families and for people, with very little impact upon government itself. The answer is yes. So, why not do this instead of just simply hold on desperately to that last dollar of revenue when, in fact, what we're seeing is a boon in the wash of revenue as a result of growth of this industry.

Mr. PICKERING. Mr. Chairman, let me just close with a comment, and join with some of my other colleagues who have commended your leadership. You are a Governor of a rapidly growing State, with a high tech economy. That growth, especially in northern Virginia, is spurring benefits for all of us. It is really remarkable to see, the difference the high tech economy can make. You know, when I came to Congress and cast my first vote, I saw on the lights "yea," "nay" or "present." I looked at that "present," and I said that would be the greatest advocacy of my duty if I ever pushed that "present" button. So, I want to commend your leadership with taking a position. Agree or disagree, you took a position. You're advocating, you're defending it, and it is very disappointing to see the Clinton Administration, and I try to be bipartisan when it comes to telecommunication and technology on policy, but to abstain in this important matter, I think it's a great advocacy of leadership, of responsibility, and it definitely would not go down into the book of profiles of courage. So, I commend your leadership and look forward to working with you on these issues in the future.

Governor GILMORE. Thank you, Congressman.

Mr. TAUZIN. The gentleman yields back the balance of his time. The time of all members has expired. Governor, I'm going to recognize the ranking minority member, Mr. Markey, for final comments. I will have a few, and then we will thank you very much for the generosity of your time and effort here. Mr. Markey.

Mr. MARKEY. I thank you, Mr. Chairman. I know that Commissioners Jones and Kirk and Leavitt and LeBrun and Locke actually have their own detailed proposal as well. It's not as though they're absenting themselves from the debate. It is that they have their own detailed proposal which they—

Governor GILMORE. Indeed.

Mr. MARKEY. [continuing] which they believe should be put in place as an alternative.

Governor GILMORE. Indeed.

Mr. MARKEY. I don't know what the nature of the abstention was, but I don't think it's for lack of having a substantive alternative. With that said, I do agree with the gentleman from Mississippi and everyone else who has complimented you on your exceptionally articulate presentation of your perspective on this issue today. It was a very impressive performance, and we thank you for it. It helps to really tee up this issue before this committee and before the entire Congress.

As I said in my opening statement, as we proceed in deliberations on this subject, it's important to stay focused on the central issues of any tax related matter. Is it a fair tax? Is it a fairly and equitably assessed tax? Does the tax raise revenues to meet the stated government needs, whether it be fire and police and education, or on the national level, for Medicare and Medicaid and other purposes, including defense of our Nation? Does the tax promote a specific goal for our society and economy?

I think what we heard this morning essentially distilled is the question of whether taxing the Internet is a necessary. The flip side, however, of the question is whether the giving of the Internet of a special tax break is a necessity or not. Is it equitable or not? I look forward to continuing the discussion on that subject as well.

I think that the Governor has done an excellent job. I hope that the subcommittee continues to bring in experts on the subject. We can benefit from all of the incredible time and effort that they expended in distilling this debate down to a form which I think is now highly useful for Congress, and I thank you, Governor, for your excellent presentation.

Governor GILMORE. Thank you, Congressman.

Mr. TAUZIN. Thank you, Congressman Markey. Finally, Governor, on a personal note, on behalf of my children, thank you for doing all you've done to reduce that awful car tax in Virginia. They have all asked me to personally tell you that, and I'm sure you hear that a lot from folks in Virginia. Second, to thank you for the extraordinary time you've given us today and the effort you put into this. Mr. Markey has said it well when he said that your presentation has been extraordinarily articulate and to the issues for us.

Second, to point out that, I think I referred to this earlier, but you know that Dick Armey and I have gone around the country. Others are doing the same thing now, talking about an alternative form for Federal taxation as it applies to the States. There is talk about going to a national sales tax. I know that you were asked that question, and I know you did not consider it as part of the Commission's work. I simply wanted to point out that if there is ever going to be a rationalization of this system, it may be on some level like that, either a declaration nationally or the nexus issue, as you recommended to us or some alternative that makes sense nationally.

The bottom line is that not all of us share the view that in the process, we have to guarantee government's level of income. Second, the government has an obligation in many of our views to use some of the efficiencies of the Internet to cut down its own expenditures and to save money the way many companies and many indi-

viduals are saving money through the use of these technologies today. All of that has to be factored in here somewhere.

The bottom line is you have added to our discourse today. I realize we could have waited until the report was filed, but you have come in early and given us a summary and helped us immeasurably. We thank you for that. We thank you for, indeed, the service you've provided for the country because these issues will not go away. My guess is we will be looking at an extension of the moratorium that Congress has passed before this committee very soon, and we will continue to seek your counsel and advice as we go forward.

Mr. MARKEY. Mr. Chairman, if I may, briefly.

Mr. TAUZIN. Yes, Mr. Markey.

Mr. MARKEY. Yes, in addition to your work in doing away with the automobile tax in Virginia, if, Governor, you could by some way in which everyone of us in this country and all around the world was able to re-register our cars online so that we could do away with the Department of Motor Vehicles of the world, I think each of us would be willing to support you for world commissioner. I think you can skip any other ambitions you might have that would be as an intervening career step before you reach world commissioner status. Those of us continue to work on that particular area of expertise.

Mr. TAUZIN. And those of us who don't believe in one world government would ask you to seek some other great advancement in your career.

Thank you so much, and the hearing stands adjourned. The Chair wishes to announce that the subcommittee will reconvene at 1 for the consideration of our second issue, which is the issue of uniform sourcing.

[Whereupon, at 12:18 p.m., the subcommittee recessed, to reconvene at 1 p.m., this same day.]

[Additional material submitted for the record follows:]

**The Sky Is Not Falling:
Why State And Local Revenues
Were Not Significantly Impacted
By The Internet In 1998***

By:

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and
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Ernst & Young LLP
Economics Consulting and Quantitative Analysis

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* This study was prepared for the eCommerce Coalition, a broad-based, national coalition dedicated to providing sound policy information on the taxation of electronic commerce. The Coalition members include America Online, Inc., Andersen Consulting LLP, Cisco Systems, Inc., FirstData Corporation, Intuit, Inc., Microsoft Corporation, Time Warner, Inc., Wal-Mart Stores, Inc.

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**THE SKY IS NOT FALLING: WHY STATE AND LOCAL REVENUES
WERE NOT SIGNICANTLY IMPACTED BY THE INTERNET IN 1998**

Executive Summary

Ecommerce, the purchase of goods and services by consumers over the Internet, is raising important tax policy issues for state and local governments, consumers and retail sellers. Many state and local officials have expressed concerns about potential erosion of the state and local retail sales and use tax base. Ecommerce firms are concerned about the administrative and compliance costs of different sales and use tax systems at different rates applied to different bases in 45 states and thousands of additional cities, counties and other local governments.

This study analyzes the potential erosion of state and local sales and use tax revenues from the growth of ecommerce. **The “revenue crisis” from Internet sales has not materialized. The Advisory Commission on Electronic Commerce, state and local governments, and Congress have time to carefully deliberate on the appropriate taxation of ecommerce.** The future sales and use tax system of state and local governments should be fair, minimize adverse economic costs, encourage economic growth, reduce taxpayer compliance costs, and minimize government administrative costs.

Key Findings:

- The impact on state and local governments’ sales and use tax revenues from ecommerce retail sales must be considered in the context of the current state sales and use tax systems.
 - Interstate (“remote”) sales are not subject to sales or use tax collection by companies without nexus (i.e., no physical presence in the taxing state) based on Supreme Court rulings.
 - Most services and intangible products are not subject to sales and use tax. Many tangible goods (e.g., groceries, apparel, prescription drugs) are also exempt from sales and use tax in many states.
 - Taxable purchases from remote sellers are subject to use tax, but states are not effectively enforcing their existing laws on their citizens.
- Although ecommerce retail sales have grown rapidly and are receiving wide-spread attention, the approximately \$20 billion of business-to-consumer (“retail”) sales over the Internet in 1998 represent less than three-tenths of one percent of total consumer spending.
- An estimate of the sales and use tax not collected in 1998 from the increase in remote sales due to the Internet is less than \$170 million, or only one-tenth of one percent of total state and local government sales and use tax collections. This small effect is due to a number of factors:
 - An estimated 80 percent of current ecommerce is business-to-business sales that are either not subject to sales and use taxes or are effectively subject to use tax payments by in-state business purchasers.

- An estimated 63 percent of current ecommerce business-to-consumer sales are intangible services, such as travel and financial services, or exempt products, such as groceries and prescription drugs, which generally are not subject to state and local sales and use taxes.
 - Substitution of ecommerce purchases for sales from other remote sellers (e.g., mail order and telemarketers) does not result in reduced sales and use tax. A conservative estimate of 60 percent of ecommerce purchases of tangible products that would otherwise be made by phone or mail further reduces the potential erosion.
 - Some current ecommerce sales result in sales and use tax from ecommerce sellers remitting sales and use tax to states where they have nexus and some ecommerce buyers complying with use tax.
 - Five states do not have state sales and use tax, and 19 states do not allow local governments to impose sales or use tax.
- Based on the factors above, approximately \$2.6 billion or only 13 percent of total ecommerce retail sales have potential sales and use tax collection issues. **Applying state and local sales and use tax rates to the potential tax base results in sales and use tax erosion of less than \$170 million in 1998. This is only one-tenth of one percent of total sales and taxes collected by all state and local governments.**
 - The potential erosion of sales and use tax is not an erosion of tax *liability*. Although out-of-state sellers without physical nexus have no legal obligation to collect sales and use taxes from in-state consumers, the in-state consumers still have a use tax liability. The potential erosion of tax *collections* is due to lack of effective enforcement of the existing use tax by state and local governments.
 - As further evidence that a “revenue crisis” is not at hand, state and local sales and use taxes continue to grow at the average growth rate experienced throughout this decade. And many state governments have record level budget surpluses.

Since ecommerce combines complex new issues of interstate taxation and of legal definitions of what is taxable, it will be very difficult to address these issues through marginal adjustments in the current state and local tax laws. Instead of short-term, ad-hoc law changes, the Advisory Commission on Electronic Commerce, state and local governments, and Congress should consider longer-term, more comprehensive changes in the state and local tax structure. There is time to carefully construct a fair, efficient, and administrable tax system for state and local governments for the 21st century.

THE SKY IS NOT FALLING: WHY STATE AND LOCAL REVENUES WERE NOT SIGNIFICANTLY IMPACTED BY THE INTERNET IN 1998

I. Overview

The rapid growth in electronic commerce (ecommerce) over the Internet has raised concerns among state and local governments about possible adverse effects on sales and use tax collections and on economic competitiveness of in-state sellers. Ecommerce joins traditional forms of direct marketing as an important alternative retail channel for consumers to purchase goods and services from remote sellers. Since sellers in the Internet retail market can be located in a number of taxing jurisdictions, ecommerce transactions add another dimension to the complex issue of how to administer the sales and use tax on purchases from out-of-state sellers.

The retail sales and use tax, designed in an earlier era to tax primarily sales of tangible products, is not well-suited to effectively tax interstate transactions involving services as well as products. The interstate dimension of Internet sales is not a new phenomenon. Mail order catalog retail sales have posed a challenge to the collection of retail sales and use taxes that federal, state and local governments have struggled with since the mid-1960s. In addition, some states have been modifying their sales and use taxes to expand the tax base to include an increasing share of rapidly expanding consumer spending on services.

What is unique about ecommerce is that it is simultaneously blurring both the geographic boundaries between states and the definitional boundaries between goods and services. It is this combination, along with the growth in ecommerce sales, that has raised fundamental questions about the sales and use taxation of electronic commerce.

The objective of this paper is to provide estimates of the potential size of uncollected state and local sales and use taxes on ecommerce transactions between businesses and consumers and to compare these estimates to the current level of state and local sales and use tax collections. The paper also frames the issue of taxing retail ecommerce in the broader context of sales and use taxation of all goods and services, regardless of the method used to complete the transactions.

II. State and Local Sales and Use Taxes

The sales and use tax is an important state tax, accounting for one-third of all state taxes and one-fourth of total revenue raised by the states. The sales and use tax is less important as a local source of revenue accounting for approximately 11 percent of local taxes. For state and local governments combined, the sales and use tax provides one-quarter of all taxes.

As shown in Table 1, the importance of the sales and use tax varies significantly across states with five states (Florida, Nevada, South Dakota, Tennessee and Washington) receiving more than 50 percent of their taxes from the sales and use tax. At the other end of the spectrum, six states (Maryland, Massachusetts, New York, North Carolina, Vermont and Virginia) receive less than 25 percent from the sales and use tax. Five states do not have a state-level sales and use tax. This wide variation in

reliance on the sales and use tax means that the revenue impact of not taxing remote sales also varies widely across states.

The sales and use tax generally applies only to tangible personal property with relatively few consumer services included in the tax base. As a result, the rate of growth in state and local sales and use taxes has been slowed by the shift of consumer spending away from tangible products (durable and non-durable) to personal services (e.g., personal care, personal business and recreation spending). In fact, over the last decade the rate of growth in consumer spending for services has exceeded the growth rate of durable goods consumption by 35 percent and the growth rate of non-durable spending by almost 50 percent. As will be discussed, a large component of Internet sales includes services, such as stock brokerage and travel transactions, that are generally not taxable regardless of the retail distribution channel.

The more rapid growth in consumer spending on services and other non-taxable goods has resulted in a steady decrease in the ratio of taxable consumer spending and total consumer spending. This is evident in Figure 1 that plots the percentage of U.S. consumer spending that we estimate is taxable under state and local sales and use taxes. With the exception of the early 1990s recession, the taxable share of consumption has been falling since 1985.

The important point to make in the context of sales and use taxation of ecommerce is that this "erosion" of the sales and use tax base has been going on for at least a decade prior to the advent of ecommerce. While increased remote sales over the Internet may result in some substitution of non-taxable for future taxable retail sales, as discussed in detail below, the changing composition of how consumers spend their money, not how they purchase their goods and services, has been the key factor contributing to the slower growth of state and local sales and use taxes.

Table 2 shows a shorter-run view of the recent growth in state sales and use tax collections. It shows that the rate of growth of state sales and use taxes have actually increased over the last three years. The fiscal year 1998 growth rate, 5.6 percent, almost matches the compound growth rate of 5.7 in the decade of the 1990s. Although these figures have not been adjusted for tax rate or tax base changes, they provide no evidence of a slowdown in the rate of growth of state sales and use tax collections. In fact, state sales and use tax collections have grown faster than total retail trade during the past eight years, including 1997 and 1998.

III. Ecommerce Impacts on State and Local Sales and Use Taxes

In this section we present preliminary estimates of the revenue impact of ecommerce in terms of potential reductions in state and local sales and use tax collections.

Methodology for Estimating Sales and Use Tax Impacts

The following questions must be answered to accurately assess the impact of ecommerce on state and local sales and use tax revenues:

- What transactions are included in the definition of ecommerce?
- What is the estimated size and composition of ecommerce transactions in 1998?

- What categories of ecommerce retail sales are subject to state and local sales and use taxes under current law?
- For the ecommerce transactions that are subject to sales and use tax, what proportion of the sales are expected to produce sales and use tax payments under current law and administrative practices?
- For taxable ecommerce transactions that do not generate sales and use tax payments, what percentage of these sales are substitutes for sales that were not paying sales and use tax, and what percentage are sales that result in reduced sales and use tax collections?
- How does the estimated reduction in state and local sales and use tax collections attributable to ecommerce compare to the amount of actual collections in 1998?

Each of the steps in the estimation process is explained in the following sections. The basic approach we are using is to 1) determine the percentages of estimated Ecommerce transactions that fall into each of the above categories, and 2) to apply these percentages to aggregate estimates of Ecommerce transactions to determine sales and use tax impacts. The next section explains how we determine the key percentages.

Ecommerce Sales Subject to State and Local Sales Taxes

Total ecommerce sales can be divided into business-to-business sales and business-to-consumer sales. We estimate that 80 percent of total ecommerce transactions are business-to-business sales, while 20 percent are business-to-consumer sales. The business-to-business sales are an extension of electronic data exchange systems that have been in use for some time.¹

A significant share of business-to-business transactions are not taxable under retail sales and use taxes because 1) they are exempt under sales-for-resale provisions and various manufacturing exemptions, or 2) they are non-taxable business services. For business-to-business sales that are taxable, if the seller does not collect the tax, the purchasing firms are subject to a use tax that is paid directly to tax agencies.² For large business taxpayers, use tax payments are subject to frequent and on-going compliance review.

¹Estimates of the distribution of total ecommerce sales are based on information from the Organization for Economic Co-Operation and Development, *The Economic Impact of Electronic Commerce*, 1999.

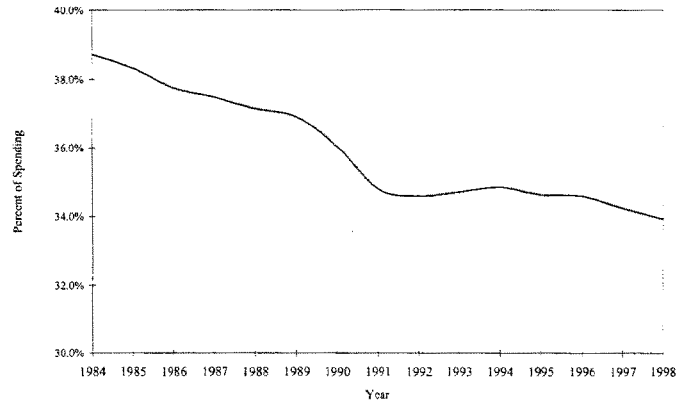
² Under the retail sales and use tax in most states, if the seller does not collect a tax on taxable sales, the purchaser is liable to pay a use tax at the same rate as the sales and use tax. Use tax collections, primarily paid by businesses on taxable inputs that they purchase free of sales and use tax, are significant in total. It has been estimated that use taxes average roughly 10 percent of reported sales and use tax collections. (John F. Due and John L. Mikesell, *Sales Taxation: State and Local Structure and Administration*, Urban Institute Press (1994), p. 246.)

Table 1
State Sales Tax Revenue, Fiscal Year 1998

State	State Sales Tax (millions)	Percent of Total State Taxes	Percent Change 1997 - 1998
United States	\$150,609	36.7	5.6
Alabama	1,584	29.3	4.7
Alaska	—	—	—
Arizona	2,368	48.0	7.1
Arkansas	1,492	41.6	3.2
California	21,260	37.4	6.4
Colorado	1,536	31.2	8.7
Connecticut	2,762	34.5	6.3
Delaware	—	—	—
Florida	11,838	70.0	7.0
Georgia	4,143	37.2	1.6
Hawaii	1,425	50.0	-2.2
Idaho	653	32.9	5.0
Illinois	5,312	32.8	5.6
Indiana	3,279	32.9	4.2
Iowa	1,515	33.9	3.7
Kansas	1,537	39.9	9.7
Kentucky	1,981	34.6	5.2
Louisiana	2,012	38.5	1.6
Maine	791	40.0	19.4
Maryland	2,161	29.9	3.2
Massachusetts	2,963	21.2	3.0
Michigan	6,713	35.3	3.9
Minnesota	3,697	36.5	8.3
Mississippi	2,035	44.8	6.3
Missouri	1,706	26.7	-0.4
Montana	—	—	—
Nebraska	804	38.2	6.3
Nevada	1,656	80.2	4.2
New Hampshire	—	—	—
New Jersey	4,766	33.7	8.0
New Mexico	1,121	44.6	4.7
New York	7,308	21.2	3.5
North Carolina	3,255	28.3	4.1
North Dakota	316	41.4	1.5
Ohio	5,266	37.1	6.0
Oklahoma	1,328	32.4	4.4
Oregon	—	—	—
Pennsylvania	6,152	34.6	1.9
Phila	9,962	35.3	5.7
Rhode Island	530	33.2	8.4
South Carolina	1,742	37.3	6.6
South Dakota	388	71.5	5.8
Tennessee	4,070	60.3	4.6
Texas	14,706	59.1	10.0
Utah	1,252	38.8	0
Vermont	202	25.1	10.0
Virginia	1,919	21.9	5.1
Washington	4,964	52.6	5.9
West Virginia	878	34.7	2.9
Wisconsin	3,047	32.3	6.4
Wyoming	175	39.6	10.5

Source: *State Tax Notes*, "Another Banner Year for State Tax Collections in Fiscal 1998," May 12, 1999.

Figure 1
Falling Share of Consumer Spending
Subject to Sales and Use Taxes



Source: Authors' calculations from, *Survey of Current Business*, U.S. personal consumption expenditures.

Table 2
State Sales and Use Tax Collections

Fiscal Year	State Sales Tax Collections (millions)	Percent Annual Growth Rate in State Sales Tax	Percent Annual Growth Rate in Total Retail Trade
1998	155,300	5.6	5.1
1997	147,069	5.5	4.3
1996	139,363	5.4	5.7
1995	132,236	7.5	4.5
1994	123,006	7.3	7.5
1993	114,635	5.4	6.3
1992	198,734	5.4	5.2
1991	103,166	3.5	0.6
Compound growth rate, 1991-1998		5.7%	4.9%

Source: US Bureau of Census, *Governmental Finances*, 1991-1997., US Bureau of Census, *Monthly Retail Trade Survey*, 1991-1997. 1998 taxes estimated by applying the 1998 growth rate from K.M. Landers and D.J. Boyd, *Another Banner Year for State Tax Collections in Fiscal 1998 to 1997 collections*.

For all of the above reasons, state and local government officials have not expressed concern about business-to-business ecommerce, but have focused on business-to-consumer sales. The estimate of total 1998 business-to-consumer sales used in this study is \$20 billion.³ This is the segment of ecommerce that is causing the most concern in terms of retail sales and use tax administration and compliance and is the figure we use to estimate the retail sales and use tax impacts of ecommerce.

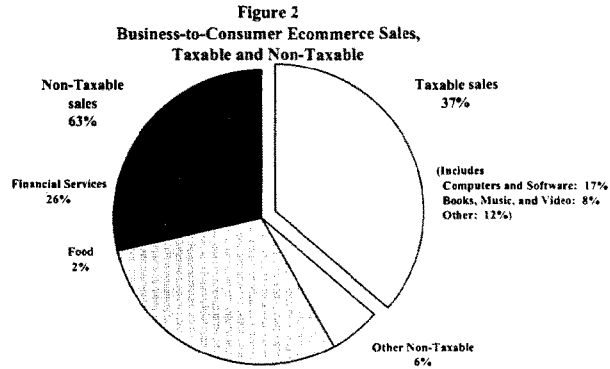
The first step in deriving sales tax impacts is to divide total business-to-consumer sales into taxable and non-taxable sales. Based on estimates of the amount of ecommerce sales to consumers by type of spending and identification of taxable sales categories by state, we estimate that 63 percent of consumer ecommerce purchases are not subject to retail sales and use taxes. Figure 2 identifies the types of business-to-consumer sales that are not taxable, as well as the categories that are taxable.

While the definition of the sales and use tax base varies substantially from state-to-state, ecommerce products and services generally not taxable include: personal financial services (electronic banking, bill paying, stock broker services and insurance), interactive games, travel tickets and services, groceries, on-line subscriptions to newspapers and Internet gambling. Because current retail sales and use taxes exclude most forms of intangible services, a significant portion of business-to-consumer ecommerce transactions will not be taxable without a significant restructuring of the current-law sales and use tax-base.

As shown in Figure 2, we estimate that only 37 percent of projected total ecommerce retail sales to consumers are subject to retail sales and use taxes. Included in this category of current retail goods and services provided to consumers over the Internet are: jewelry and gifts, flowers, electronic products, shoes and clothing, books, tapes and compact disks, alcohol and household products.⁴ Figure 2 shows the distribution of the major taxable categories. This relatively small set of total ecommerce transactions is the potential source of sales and use tax collection erosion that is the concern of state and local governments.

³ This is a total revenue estimate on the high-end of a wide range of estimates that are being produced by industry experts, academics and private consulting firms. The large variance in estimates is due partly to the lack of detailed data from traditional federal data sources and to differences in the definition of what is included in business-to-consumer sales. The \$20 billion estimate for business-to-consumer Internet retail sales is consistent with the recent estimates of total ecommerce sales in the U.S. in 1998, \$102 billion published by the University of Texas, Center for Research in Electronic Commerce (www/internetindicators.com, June 1999). Forrester Research, Inc. figures for online retail sales in 1998 are \$8 billion, but exclude financial services. Research estimates reported by Boston Consulting Group and shop.org show 1998 retail online revenues of \$13 billion.

⁴ The sale of motor vehicles is, in a number of states, subject to the retail sales and use tax. The collection of this tax, regardless of how the vehicles are purchased, is effectively ensured through state and local registration systems. For this reason, motor vehicle purchases are not included in the estimate of taxable business-to-consumer ecommerce sales that may not pay sales or use tax. It should also be noted that the percentage of taxable retail ecommerce sales shown in Figure 2 is higher than the estimated percentage of all consumption spending that is taxable as shown in Figure 1 due to differences in the composition of spending.



Estimates of the Sales and Use Tax Not Collected on Retail Ecommerce Sales

The final step in the estimation process is to determine what the net effect of the estimated taxable Internet sales had on state and local sales and use tax collections in 1998. This step is a complicated one that has to consider compliance issues, as well as possible substitutions between ecommerce sales and retail sales through more traditional retail channels, such as mail-order sales, that do not result in sales or use tax collections.

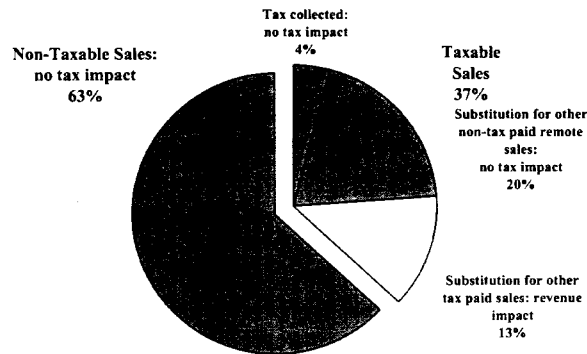
Figure 3 illustrates how we divided the 37 percent of business-to-consumer sales that are subject to sales and use taxes into three categories: sales generating taxes, sales substituting for other sales not generating taxes, and sales resulting in reduced tax collections.

As shown in Figure 3, we estimate that 4 percent of taxable business-to-consumer ecommerce sales result in sales and use tax payments.⁵ These payments would be made primarily by in-state ecommerce firms or out-of-state firms that have sufficient nexus in a state to be required to collect and remit sales and use taxes. A relatively small additional percentage would be paid as use taxes by individual consumers. There is no loss of state and local sales and use taxes associated with this category of taxable ecommerce sales.⁶

⁵ The estimated percentage is conservative compared to the 16.5 percent estimate reported in U.S. Advisory Commission on Intergovernmental Relations, *Taxation of Interstate Mail Order Sales: 1994 Revenue Estimates* (May 1994), which did not include Sears, J.C. Penney and Spiegel, which collected sales and use taxes in all states.

⁶ The estimate of the percentage of taxes on taxable sales paid by vendors is based on an informal survey of several state tax agencies and prior studies. The potential positive effect of additional taxes paid by ecommerce vendors on new taxable sales is not included in the revenue impact estimates.

Figure 3
Tax Treatment of Ecommerce Business-to-Consumer Sales



The second category of taxable ecommerce retail sales identified in Figure 3 are sales that do not reduce sales and use tax collections because they substitute for other taxable remote sales that are not currently generating sales or use taxes; both types of sales result in non-payment of sales and use taxes. We estimate that this category accounts for 20 percent of business-to-consumer sales. The displaced sales, for example, could come from multi-channel retailers that replace mail or telephone sales with online retail sales over the Internet.⁷ These may be out-of-state retailers that do not have the required nexus to collect sales and use taxes from in-state consumers.⁸ The substitution figure is probably on the low side. Research suggests that specific categories of online retail sales, such as computers, are very close substitutes for other direct marketing sales by mail or telephone.⁹

⁷ The shop.org/Boston Consulting Group study of 127 online retailers found that "Although there is a proliferation of retailers selling online, revenues are still concentrated in only a few mature sites." Further, "Multichannel retailers, like Dell, Schwab, Eddie Bauer and Lands End, account for 59% of online revenues."

⁸ The U.S. Supreme Court in the 1967 *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* case clearly established the legal principle that out-of-state catalogue sales companies do not have to collect and remit a use tax from customers in a state where the companies do not have legal nexus for sales and use tax purposes. The U.S. Supreme Court's position was reaffirmed in the 1992 *Quill Corp v. North Dakota* case dealing with the definition of in-state sales for a mail-order firm.

⁹ In a recent study of online retail transactions, the author found that online computer sales and mail-order sales are very similar in terms of responses of purchasers to tax rate differences. This suggests that there may be a high degree of substitution between mail-order and online computer sales. (Austan Goolsbee, *In a World Without Borders: The Impact of Taxes on Internet Commerce*, National Bureau of Economic Research, November 1998.) It should be noted also that total direct marketing sales are estimated to be \$1.4 trillion dollars in 1998 (Direct Marketing Association, *Economic Impact: U.S. Direct Marketing Today, 1998*, February 1999). A significant portion of these sales provides an opportunity for ecommerce sales substitution.

The final category in Figure 3 is the one that results in a loss of sales and use tax collections. This category, an estimated 13 percent of taxable business-to-consumer ecommerce sales, is the only sales category resulting in a loss of state and local sales and use tax revenue. The loss comes from taxable ecommerce sales, not generating sales taxes, that substitute for tax-paid sales under traditional retail channels. An example of transactions that may displace tax-paid sales include the purchase of a book from an out-of-state seller over the Internet, rather than from a local bookstore, that is delivered by common carrier without either the seller or the buyer paying the use tax.

To estimate the size of this revenue loss in 1998, we applied the estimated percentage of taxable ecommerce retail sales not paying sales and use tax (13 percent) to the estimate of taxable ecommerce business-to-consumer sales (\$7.4 billion) to derive an estimate of the total U.S. taxable ecommerce sales base that is not paying sales and use taxes (\$2.6 billion). We then distributed this sales and use tax base by state, including states without sales and use taxes, in proportion to state personal income. This distributed base was then adjusted for major differences in the scope of sales and use taxation of services for selected states. The resulting state-by-state sales and use tax bases were then multiplied by the 1998 combined state and local sales and use tax rates in each state to estimate aggregate sales and use tax losses.

The sales and use tax revenues at issue in 1998 from business-to-consumer ecommerce transactions for all state and local governments are an estimated \$170 million, only one-tenth of one percent of total sales and use tax collections.

Table 3 provides a summary of each of the key steps in deriving the estimated 1998 revenue impact of \$170 million.

Table 3
Summary of Ecommerce Sales and Use Tax Impacts, 1998

Steps	Percent of Sales	Amount (millions)
Total Business-to-Consumer Sales	100	20,000
Less: Percent Non-Taxable	63	<u>-12,600</u>
Equals: Taxable Sales	37	7,400
Less: Sales Tax Paid	4	-800
Less: Sales Substituting for Other Remote Sales, No Tax Collected	20	<u>-4,000</u>
Equals: Sales, No Tax Collected	13	2,600
Times: Average State and Local Tax Rates		6.5%
Equals: Estimated Sales Tax Loss		\$170

Since the sales and use tax impact is only one-tenth of one percent in 1998, even if ecommerce sales doubled annually for the next three years, the revenue impact would still be less than one percent of state and local sales and use tax revenues. As a percentage of total state and local tax revenue, the impact would be less than two-tenths of one percent.¹⁰

Comparisons With Estimates of Sales and Use Tax Losses From Mail-Order Sales

The small impact of business-to-consumer ecommerce on state and local sales and use tax collections in 1998 can be put in perspective by comparing the ecommerce estimate to estimates of state and local sales and use tax revenue losses from mail-order sales.

The problem of collecting sales and use taxes on taxable consumer purchases from out-of-state suppliers is similar for both ecommerce and mail-order sales. States have been dealing with mail-order sales and use tax administration and collection issues for some time, and there have been on-going efforts to estimate sales and use tax revenue losses associated with mail-order sales.

¹⁰ Austan Goolsbee and Jonathan Zittrain, *Evaluating the Cost and Benefits of Taxing Internet Commerce*, May 1999, find 1998 sales and use tax revenue impact from retail ecommerce that are similar in magnitude to the findings in this study.

The most comprehensive state-by-state estimates of the sales and use tax revenue loss from mail-order sales were prepared by the U.S. Advisory Commission on Intergovernmental Relations. The study estimated that mail-order sales resulted in an aggregate revenue loss of \$3.3 billion in sales and use tax collections in 1994.¹¹ This was approximately 2.4 percent of total sales and use tax collections for all states. If this percentage is applied to the 1998 level of state and local sales and use tax collections, a conservative estimate of the uncollected sales and use taxes related to mail-order sales is \$4.5 billion.

IV. Conclusions

The preliminary estimates presented in this paper suggest that the revenue impact from ecommerce is very small in both dollar amounts and relative to the revenue erosion caused by the economy's growth of services and other forms of remote sales, including mail-order sales. For all state and local governments, the collections at issue in 1998 are estimated to be \$170 million, less than one-tenth of one percent of state and local sales and use tax revenues.

The current \$170 million impact of ecommerce on state and local and use tax collections contrasts sharply with the concerns expressed by some officials:

Nevada Department of Taxation Executive Director Michael A. Pitlock: "Looking at the national numbers, (Internet commerce) is now a significant concern." (January 31, 1999, Las Vegas Review-Journal)

"The National Association of Counties said Wednesday that the Internet-related loss of state and local sales and use tax revenue is estimated to be anywhere between \$15 billion and \$50 billion a year nationwide by 2005." (The Buffalo News, April 1, 1999)

The small impact of Internet taxation on state and local tax revenues in 1998 should also be compared to the states' budget situation. According to the latest *Fiscal Survey of the States*, the continuing strong economy produced general fund budget surpluses in almost all states in fiscal year 1998.¹² In the aggregate, end-of-year balances reached \$36 billion, 8.8 percent of general fund expenditures in fiscal year 1998. These balances remained after tax cuts passed during the year. Twenty-one states had balances of 10 percent or more of expenditures.

Although ecommerce sales are growing rapidly and are receiving wide-spread attention, there is only a small current negative impact on sales and use tax collections for several important reasons:

- 80 percent of all ecommerce sales are business-to-business sales that are either nontaxable or on which businesses pay a use tax. These business-to-business sales are much less of a compliance issue because of well-established sales and use tax audit procedures for in-state businesses.

¹¹ Due and Mikesell, *Sales Taxation*, have noted that the methodology used by ACIR in their original estimates in 1991 overstated the revenue loss from mail-order sales by not adequately including use tax revenue collected by registered in-state firms and out-of-state firms that have nexus to collect the tax or that are voluntarily collected use tax.

¹² The National Governor's Association and the National Association of State Budget Officers, *The Fiscal Survey of the States*, December, 1998

- 63 percent of business-to-consumer ecommerce sales are intangible services and exempt products that are not taxable under most state and local sales and use taxes.
- 11 percent of taxable ecommerce retail sales result in taxes being paid by either vendors or consumers.
- 60 percent of the taxable business-to-consumer sales are substituting for other sales that do not generate sales and use taxes and do not result in new sales and use tax losses.

It should be noted that the potential erosion of sales and use tax is not an erosion of tax *liability*. Although out-of-state sellers without physical nexus have no legal obligation to collect sales and use taxes from in-state consumers, the in-state consumers still have a use tax liability. The potential erosion of tax *collections* is due to lack of effective enforcement of the existing use tax by state and local governments.

An important implication of this study's findings is that states have sufficient time to carefully evaluate alternative options for taxing ecommerce. In addition, the problems associated with collecting retail sales and use taxes on ecommerce business-to-consumer sales must be discussed within the broader context of how to effectively tax services, as well as remote transactions, under sales and use tax systems designed in an earlier era to tax in-state, tangible personal property.

In summary, the sales and use tax "crisis" from Internet ecommerce transactions is not at hand. The Advisory Commission, state and local governments, ecommerce firms and Congress have time to carefully deliberate on the most appropriate, long-term method for effectively taxing ecommerce transactions. The solution will be found in coordinated changes to the current tax system that recognize the much broader issue of effectively taxing interstate sales under a simpler, more uniform tax system.

In addition, the restructured tax system will have to simultaneously address additional tax policy goals of fairness, economic efficiency and uniformity, long-term revenue responsiveness, and reduced taxpayer compliance and government administration costs. This is a challenging, complex task that will require much more than marginal adjustments in current sales and use taxes. Fortunately, this study suggests that there is sufficient time for the stakeholders to carefully consider the alternatives.

