THE INTERNET SERVICES PROMOTION ACT OF 2000, AND THE INTERNET ACCESS CHARGE PROHIBITION ACT OF 1999

HEARING

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS, TRADE, AND CONSUMER PROTECTION

OF THE

COMMITTEE ON COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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ON

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WEDNESDAY, MAY 3, 2000

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

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

Members present: Representatives Tauzin, Stearns, Gillmor, Cox, Largent, Rogan, Shimkus, Pickering, Ehrlich, Bliley (ex officio), Markey, Boucher, Gordon, Rush, Luther, Sawyer, Green, McCarthy, and Dingell (ex officio).

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

Mr. TAUZIN. The subcommittee will please come to order.

Today the subcommittee begins review of two important pieces of legislation, H.R. 1291, introduced by our good friend, Mr. Upton, and H.R. 4202, legislation sponsored by Mr. Ehrlich. The issue of interstate access charges has been with us and with this subcommittee since 1983, when the FCC first constructed its access charge regime. In recent years the FCC's access charge exemption for information service providers has been and continues to be a subject of much debate.

Some have argued that the rationale for this exemption no longer makes sense because the information services industry is no longer in its infancy as it was in 1983. In fact, many ISPs are larger in terms of market capitalization than many telecommunications service providers that still must pay permanent access charges.

On the other hand, there are those who feel that imposing permanent access charges on ISPs would result in dramatically increasing the consumer price of dial-up access to the Internet.

The current exemption they argue enables ISPs to continue charging customers flat rate monthly fees for access to the Internet, whereas long distance charges are computed based on minutes of use.

The subcommittee recently heard from Governor Gilmore of Virginia, the Chairman of the Advisory Committee on Electronic Commerce, on this very issue. He believes that permanent access charges would suppress the demand for Internet services and as

such would stifle innovation in the electronic marketplace. Consumers today stay on-line for lengthy periods of time, sometimes for several hours. When confronted with time sensitive charges, consumers will necessarily pull back and limit their time spent surfing the Web per week, and not surprisingly unload on Congress for authorizing Internet service price hikes.

To ensure that ISPs do not inflict rate shock on their subscribers, I have joined with Fred Upton in cosponsoring H.R. 1291, which is intended to prevent time based access charges from being imposed on consumers. Since the introduction of H.R. 1291, I think that all of us have learned a great deal more about the subject and unfortunately the complexity of the FCC web of access charges. When the 1983 exemption from access charges was promulgated, there was little surface traffic, and certainly no Internet traffic.

As a result, we have a fine line to walk here. We must ensure that those consumers who use their computers to view a Web site, send an e-mail or purchase a service or product are not charged on a permanent basis. Simultaneously, however, we need to extensively consider whether it is still equitable to subsidize ISPs by not charging them for their fair share of the cost of their use of telephone networks, and we also need to debate issues like whether the Internet telephony or computer to computer voice services should be exempt from access charges.

I mean, think about this as we debate this bill. When telephone services become very prominent on the Internet, and therefore Internet users are accessing and using the telephone networks to make telephone calls, not to do data transmissions or ordinary Internet surfing and e-mailing, but when they actually begin making telephone calls regularly over the Internet, as many are beginning to do, is it fair for other telephone users to have to pay for those networks through access charges and yet Internet users remain exempt. There is a question of fairness and equity and concern about the viability of those networks given a world of Internet telephony.

We are going to debate that and I think before we complete this session today and before we begin markup on the bill hopefully we will have a consensus how to deal with that very thorny issue.

We have also gathered today to discuss the utility of extending the Internet Tax Freedom Act's moratorium on State and local taxes. The country is home to over 7,000 taxing jurisdictions. Many electronic retailers are small operators that could have real trouble complying with the complexity and the burden of multiple and discriminatory taxation, and so we gather today to examine whether or not we ought to extend the moratorium that we just recently enacted. We cannot lose sight, however, of what State and local taxation would mean to consumers as well as the growth of electronic commerce. At the same time all evidence suggests that States and localities are prospering even as electronic commerce grows at the same time. In short, those who asked Congress to empower the States and localities to discriminatorily tax the Internet have to make a stronger case, and I look forward to that discussion.

With all of that said, we should consider the two bills before us today with the clear understanding that they are vital components of our efforts to implement a sensible and fair policy regarding the

taxation of electronic commerce. Our debate on this important issue will ultimately determine who can and should and who will pay for the cost of providing the facilities and the capabilities necessary to make the Internet a fully operational network.

The Chair recognizes the gentleman from Massachusetts, Mr. Markey, for an opening statement.

Mr. MARKEY. I would to commend you for holding this hearing on a number of tax issues that are related to the Internet. This hearing follows the hearing that we had a few weeks ago where we heard from Virginia Governor Gilmore on his perspective on the work of the special commission we established to explore Internet taxation issues. Today we revisit the issue of Internet taxes, but also focus on the exemption that many Internet service providers enjoy from access charges.

The exemption on enhanced service provider access charges began in 1983. In the late eighties, the Federal Communications Commission began a rulemaking which sought to reverse its earlier decision. I believe that the FCC would have imposed such access charges on Prodigy and CompuServe and the other forerunners of the Internet revolution back in 1988 but for the efforts of this subcommittee which at hearing after hearing with the Federal Communications Commission sitting right at that table as we tried to persuade them that that would be the wrong route to go, that flat rate pricing was more preferable than the per minute charges that they were looking at, and I believe in many ways that was the pivotal decision.

I think if permanent charges were used today or had been used over the last 12 years, that there would have been a completely different direction that the Internet would have taken, and I am very proud of the work that this subcommittee did in the 1980's in convincing the FCC to change its position and to ensure that flat rate pricing was in fact the approach which was taken because it was the belief of the subcommittee back then that it was necessary to nurture the fledgling information industry through the retention of the exemption.

Now, one of those then fledgling beneficiaries of government protection from access charges now intends to own CNN, TNT, the Atlanta Braves and all of Time Warner, so obviously the policy was a success if in 12 years we have been able to move to the point where one of those fledgling companies now owns the most important media corporation in the world. It is quite appropriate and timely as a result to revisit this issue and to analyze the effect on consumers and e-commerce if usage sensitive per minute access charges were levied on Internet service providers.

I have battled time and again to lower universal service fees over the years, particularly access charges. I continue to believe that the current universal service support levels are excessive and bloated. We must examine the overall equities across industries of universal service obligation. It is unfair to ask consumers of local phone companies and traditional long distance services to pay the lion's share of the universal support of the network, especially if that network is utilized by Internet companies to offer competing services without such obligations, especially if those services are identical to the

services which are in fact provided by the local and long distance phone companies.

As we explore all of these Internet tax related issues, I believe it is important to keep things in perspective. The magnitude of what we are talking about is relatively small. The Department of Commerce announced just last month 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 billion for the quarter. Yet there is little question that the growth curve for on-line commerce promises to be exponential in nature. That is why this hearing is absolutely essential.

That is why, Mr. Chairman, I want to compliment you for calling this double header today. I think we are catching these issues at the point when they should be dealt with by the committee.

Mr. TAUZIN. I want to compliment the gentleman on his observation with reference to this fledgling industry becoming such a giant and also commend him for making sure that there was at least one competitor that customers could turn to when we see the awful struggle of these two titans, Disney and Time Warner. I also want to make the point it would be nice to have another competitor and maybe we can discuss that in this committee sometime.

The Chair is now pleased to recognize the author of one of the pieces of legislation we are going to hear about today, Mr. Ehrlich.

Mr. EHRLICH. Thank you, I will be brief. This is an issue that will dominate the work of this committee and Congress for years to come. I applaud the work of Chairman Bliley on telecommunications issues. It is his leadership that led to the enactment of the Telecom Act of 1996, which has provided the road map for deregulation of the industry generally. In addition, I want to recognize Mr. Fred Upton at the witness table and his bill to prohibit access fees, which I support.

Of all of the constituent letters I have received during my tenure in Congress, Internet taxation and specifically the imposition of permanent fees is by far the most popular issue. To date I have received 3700 letters asking me to oppose any efforts by Congress or the FCC to impose charges on Internet service. Regardless of whether these fees come in the form of direct or indirect charges, my constituents have made it clear that they do not want their Internet bill to resemble their telephone bill, comprised of outdated taxes and a multitude of confusing service charges.

In an effort to prevent government from imposing fees and taxes that increase the cost of Internet service for all Americans, I recently introduced H.R. 4202. The purpose of this bill is twofold: One, prohibit access charges or regulatory fees on Internet service providers and, two, extend the Internet tax moratorium by an additional 5 years. One of the primary reasons for the tremendous growth of the Internet is that government has taken a hands off approach. It is imperative that Congress prevent unnecessary fees or regulations that only serve to impede the rollout of Internet service if the Internet is to fulfill its promise of how the world communicates.

It is my understanding that there may be concerns regarding section 2 of my bill which prohibits access charges on Internet service providers. As always, I would work with any and all parties to resolve concerns, issues, or unintended consequences resulting from this provision. With respect to the moratorium, I want to recognize the hard work of my colleague, Chris Cox, in passing the original bill in 1996. This moratorium has resulted in the rabid development and deployment of electronic commerce across America. John Kasich wants to make this moratorium permanent. While I share his enthusiasm in this regard, I believe that a 5-year extension of the moratorium is appropriate and will provide Congress and the American people the evidence that is needed to determine whether the moratorium should be made permanent.

I also want to take this opportunity to recognize a leader on the Internet tax issue, the Governor of Virginia and Chairman of the Advisory Commission, Jim Gilmore, who has taken his time and talent on this important issue and provided compelling evidence for keeping the Internet tax free.

I look forward to working with him and other members of the commission to produce legislation that implements the sound policy recommendations of the commission. Once again, thank you, Mr. Chairman, for holding this hearing and I look forward to moving these bills through the committee and onto the House floor, and I yield back the balance of my time.

Mr. TAUZIN. Thank you. The Chair recognizes Mr. Boucher for an opening statement.

Mr. BOUCHER. I applaud your intention to move quickly to approve legislation which will confer a major consumer benefit through the repeal of the 3 percent Federal excise tax on telephone services. Since that tax is currently passed through to consumers, it will be the consumers of telephone services who will directly benefit from its repeal.

I also endorse your effort to extend the current moratorium on taxes that are discriminatorily applied with respect to the Internet and on multiple State and local taxation with respect to electronic commerce. And I also think that a permanent prohibition on access charges as applied to Internet service providers is appropriate.

As we make these changes, however, I want to encourage the committee this morning to consider removing another unfair charge that is associated with Internet service delivery. At the present time local telephone companies make payments to each other for the termination of one company's network of telephone calls which originate on another telephone company's network. This arrangement is called reciprocal compensation. And while the arrangement works well with regard to traditional voice based telephone traffic, it operates in an illogical and inequitable manner when it is applied to the delivery of Internet traffic. In this context it has become an entirely one-way arrangement and has no reciprocal nature. Some Internet service providers have qualified as competitive local exchange carriers, and as CLECs, they receive these payments from the local telephone company when that company's customer connects over the modem to the ISP who carries that customer's Internet account. In other words, the ISP receives from its customer traffic that derives from the local telephone company's

network and gets paid by the local telephone company for the privilege of having that information delivered to the ISP.

No calls are made in return and so all of the payments go from the local telephone company to the ISP which has qualified as a CLEC. In some other instances, CLECs have gone into business just for the purpose of serving ISPs so that they can receive these reciprocal compensation payments. And since no calls ever originate on their networks, they make no payments in return. And the problem is of truly large magnitude. Payments from CLECs under this distorted structure now total hundreds of millions of dollars annually, and those numbers are rising dramatically as the level of Internet usage increases.

It is an unfair system, and as we enact bills before us that would prohibit the imposition of access charges on ISPs, I urge that we take this opportunity to remove the current unfair reciprocal compensation fee that is associated with Internet access. It is a perfect fit, and as we confer a major benefit on ISPs, I think we also should correct the distortion in the current reciprocal compensation system.

I also applaud your statement, Mr. Chairman, that we need to look carefully at the effect on universal service support in the event that Internet telephony for the provision of long distance calling becomes commonplace, and I think that day will arrive and probably pretty soon. When that happens the access charges that long distance providers pay to local exchange carriers for terminating their traffic would no longer be paid, and I think that would have a dramatic effect on universal service support. I think it is appropriate that we consider that as we make the decisions with regard to the imposition of access charges on ISPs.

These are important subjects, and I am very pleased that the subcommittee is addressing them. I want to commend our colleagues, Mr. Upton and Mr. Ehrlich, for bringing these measures before us and I look forward to the witnesses' testimony today. Thank you.

Mr. TAUZIN. The Chair thanks the gentleman, particularly for reemphasizing some of the concerns that I think we need to address before we move the bill forward. The chairman is pleased to welcome the chairman of the full committee, Mr. Bliley for an opening statement.

Chairman BLILEY. Thank you, Mr. Chairman. With today's hearing, this committee begins the task of ensuring that the Internet remains a tax free environment. We have all talked about how important the Internet and electronic commerce are to the growth of the economy. They are the engine driving this long train of economic growth. Now comes the time for Congress to do more than pay lip service to the principles of lower taxes and deregulation.

This subcommittee will examine two bills today that give us an opportunity to provide consumers with relief from taxes and regulation. I want to commend my colleagues Bob Ehrlich and Fred Upton for their hard work in crafting these two bills. They have identified a real problem that affects our constituents as well as the development and growth of electronic commerce. We have all seen the e-mails and letters from constituents pleading us to block the FCC from imposing a modem tax or an e-mail tax. In fact, I

brought two recent examples with me this morning and I ask unanimous consent, Mr. Chairman, that they both be included in the record.

I should add that consumers are right to be concerned. While it is true that Internet service providers are currently exempt from having to pay access charges, the FCC could always change its mind. Moreover, some in the telecommunications industry continue to wage battle at the FCC and in the courts on this issue. It is clear that some have a vested stake in extending the FCC's access charge regime so that it sweeps in consumers of Internet access service.

The Ehrlich and Upton bills would block the FCC from doing so. More to the point, these bills would block the FCC from imposing permanent access charges on consumers when they log on. The practical, not to mention the political implication of doing otherwise are huge. Keep in mind that a run of the mill telephone call lasts roughly 5 minutes. By contrast a consumer stays on-line for about 45 minutes to an hour. Consumers would be understandably outraged if Congress allowed such a tax. People using the Internet grows every day precisely because the cost is falling and it is charged on a flat rate basis. The imposition of permanent access charges would undue all that.

Moreover, we should recognize access charges for what they are, an FCC imposed tax that is passed on to the American consumer. A permanent tax on Internet access hurts consumers, hurts the Internet and hurts electronic commerce, both of which depend upon affordable access to the Internet.

I support the 5-year extension of the current moratorium on State and local taxation of Internet access in electronic commerce for a number of reasons. First, it is the right thing to do for the American consumer. Electronic commerce provides consumers with untold efficiencies, many of which might dry up if States and localities extend their power to tax the Internet. Moreover, to those who say the Internet Tax Freedom Act is unfair to States and localities I would reply that the government should receive only what it needs, not what it wants and by every estimate electronic commerce poses little, if any, threat to their tax revenue needs at this time.

Let me close by acknowledging Grover Norquist, who is with us today as a member of the Advisory Commission on Electronic Commerce. He did fine work to advance the cause of lower taxes and less regulation. Thank you, Mr. Chairman, and I yield back the balance of my time.

Mr. TAUZIN. Thank you, Mr. Chairman. The Chair is now pleased to recognize the ranking member of the full committee, the gentleman from Michigan, Mr. Dingell.

Mr. DINGELL. I commend you for holding this hearing. The two bills before us deal with two important Internet policy issues. The first issue is whether Internet service providers should be subject to the traditional FCC access charge regimes or any other universal service support mechanism.

The second issue is whether the current Internet tax moratorium should be extended temporarily pending resolution of a permanent Internet tax policy. The subcommittee understands well that for-

mulating legislative policy dealing with the Internet is an inordinately complex issue and becoming increasingly so, it requires making judgments and predictions about the future evolution of Internet technology and the consumer applications that are expected to flow from it. Prognostication of this sort is nearly an impossible task given the unprecedented speed with which the Internet develops. As a result, I am more convinced than ever that we need to tread lightly and to take extreme caution when making legislative changes in the area. It is vitally important that we understand the implications of all of our actions because the economic penalty is more quick and more severe than ever before. One only has to look to the volatility of the financial markets to understand the fragile character of the new economy with which we are tinkering.

On the whole I believe the bill takes a reasonable and modest approach to dealing with the various regulatory charges and taxes on the Internet, and I commend you, Mr. Chairman, and the drafters for their thoughtful work in this regard. While I generally agree with the purpose and the intent of the bills, I have some reservations about the legislative language in each bill and I hope that we will take the time necessary to avoid serious unintended consequences.

While each bill appears aimed at protecting consumers from incurring permanent charges for Internet access, H.R. 1291 may go further than is necessary to achieve this goal. I agree that we should make sure that the access charges or other universal service support mechanisms are not applied in a way that will cause consumers to pay by the minute for their basic Internet connections. Once consumers connect to the Internet, long distance telephone paging or other services that happen to be procured over the Internet should not be treated in a discriminatory way compared with non-Internet counterparts.

This is a very important point. The statute should not prevent these services from being treated similarly to those delivered to consumers by traditional means, particularly for the purposes of determining whether or not they should contribute to support universal service. The language of H.R. 4202 may be better suited to achieve this desired result.

On the issue of Internet tax I believe it is wise to extend to extend the moratorium contained in the Internet Tax Freedom Act for some period of time. The moratorium was drawn narrowly to apply to taxes imposed on Internet access and to multiple or discriminatory State and local taxes on electronic commerce. At the same time it permits States to tax remote sales via the Internet in the same way that remote sales by mail order catalogs are handled today. However, while the moratorium ostensibly allows States to impose sales and use taxes on these transactions, it is beyond dispute that the States are currently ill-equipped to collect this tax on remote sales, whether Internet or otherwise. Therefore, it is critical that a cohesive policy be put in place sooner rather than later to simplify the process for imposing and collecting taxes on these remote transactions.

As remote sales made via the Internet continue to increase exponentially, States are playing beat the clock with their ability to re-

tain in many instances greater than half their existing tax base. Given the enormity of the stakes involved for the financing of public schools, roads, police departments and other essential services, as well as a myriad of other services to our communities, it is imperative that we revisit this issue at much shorter intervals.

The 5-year extension proposed in H.R. 4202 actually would not expire until more than 6 years from today. In the time as measured by the Internet that is nearly an eternity. I hope the chairman and the drafters of this legislation will work with us to establish a more reasonable timeframe and to permit a more frequent and I think wiser opportunity to review these matters and to protect the public from potentially crippling results.

Thank you for holding this hearing. I look forward to working with you as the matter moves forward.

Mr. TAUZIN. I thank the gentleman for his thoughtful comments.

Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman. I also applaud you for having this hearing to examine the legislation of my colleague, Mr. Upton, and to preclude the FCC from imposing a per minute charge on Internet access services, as well as extending the current 3-year moratorium on State and local taxation on electronic commerce.

Mr. Chairman, I think we probably could move post haste on this bill because I think the Telecommunication Act of 1996 while it didn't address the issue of the Internet, I think the FCC with its access charge or form order in its April 1998 report on universal service, the FCC took the steps, probably the proper steps, to ensure that enhanced service providers and ISPs are not regulated as telephone carriers under title II and that enhanced service providers are identified as end users of the telephone network, thereby not paying the access charges of long distance. I think that act alone would probably justify post haste on Mr. Ehrlich's bill and Fred Upton's bill. We can combine the two of them.

At the same time, Mr. Chairman, we might as well add the idea of repealing the 3 percent telephone excise tax that was passed in 1898 and we can call this overall bill the Protection of the Consumers Who Are Using the Internet Act. I think many of us realize that way down the road if e-commerce succeeds to where everyone is buying everything off the Internet, ultimately there might have to be an adjustment. I am not sure what that adjustment might be. Cities, towns and States can get revenues from other sources, but the continued success of the Internet is—I think in the early stage is contingent on whether it is taxed or not, and I don't think it should be taxed.

I urge my colleagues to move forward on these bills and pass them this year. Thank you. I yield back the balance of my time.

Mr. TAUZIN. The Chair thanks the gentleman, also a cosponsor of Mr. Upton's bill. The Chair recognizes Mr. Gordon for an opening statement.

Mr. GORDON. Mr. Chairman, I am enjoying listening to all of these comments, and I will reserve my remarks to hear Mr. Upton.

Mr. TAUZIN. Mr. Green is recognized, the gentleman from Texas.

Mr. GREEN. Thank you. I appreciate the subcommittee's continued interest in Internet taxation. As a cosponsor of Mr. Upton's

bill, I believe that Congress cannot allow the FCC the ability to impose permanent charges on Internet access services. Through explosive growth in data traffic, permanent access charges would quickly drive consumers off and kill the promises of this cutting technology in the future. Because the access fees were originally designed for voice traffic, there was little concern about adding a few cents per minute to the fund for the maintenance of the local telecommunication infrastructure.

Unfortunately, the length of consumers' phone calls differ greatly from the time consumers spend on-line. Access charges are designed for the typical 5-minute phone call. They are not designed for the 45-minute on-line session. I believe that portions of each of these bills continuing the ban on permanent access changes is something that the subcommittee should act on immediately.

I do want to express reservations with portions of Mr. Ehrlich's bill that deals with extending the current moratorium on State and local taxation of electronic commerce for an additional 5 years. The failure of the Advisory Commission on Electronic Commerce to develop a consensus policy toward State and local taxation has left many questions unanswered.

For instance, the members of this subcommittee do not have reliable numbers as to what States stand to lose in local sales tax revenue if we extend the moratorium. My own State of Texas has no income tax and relies heavily on the sales taxes to meet our spending obligations and priorities, and I am not comfortable with the idea of excluding Internet sales from local taxation until I am sure how it will affect my own State and other States in the Nation. I question further the need for extending the moratorium when the current ban does not expire until October of next year. I believe we should use this time to gather more information and let the technology mature so we have a better idea of the true size and scope of the issue.

I want to make it clear that I don't favor raising taxes. However, we should not place a mandate on 50 States that could seriously impact their financial health in the future. The only issue that I was sure of after last month's hearing was that the majority of Governors do not feel comfortable with Congress limiting their options on this issue.

I support the continued growth of e-commerce, but right now it is the traditional small businesses in my districts that supply the jobs for my constituents. I believe the subcommittee could be better served in using the additional time that is available under the current tax moratorium to gather more comprehensive information.

I would like to thank the chairman for today's hearing and also for the hearing last month when we had Governor Gilmore. I yield back the balance of my time.

Mr. TAUZIN. The Chair recognizes Mr. Shimkus for an opening statement.

Mr. SHIMKUS. Thank you. I will be brief. I think there is consensus on the access charge issue that we need to continue the moratorium. There is a credible debate on the sale tax issue. I think technology will come around to make that doable. Although as a prior tax collector in my prior life of property taxes, I think government officials at all levels do not do their constituents good

service when we have all these sales taxes, users fees. They can't track back the amount of taxes that they are paying. When you have a property tax bill and you get the bill and you have to write the check out to fund government, that is the best way to be held accountable for the fees.

So I would challenge the States and local governments to start being prepared because this new era of technology is going to change, and I don't know if we are going to be able to keep up with it. So you may have to be more honest with your citizens and find an appropriate billing so they can track the actual cost of government and approve of those.

This is a great time to talk about technology and the future and the cost of government on our individual consumers, and I look forward to the hearing. Thank you.

Mr. TAUZIN. I thank the gentleman.

The Chair is pleased to recognize Mr. Upton. Mr. Upton, you finally got a taste what it is like to be on that side listening to all of us.

STATEMENT OF HON. FRED UPTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. UPTON. Thank you, Mr. Chairman. I appreciate the opportunity to testify on behalf of my bill, H.R. 1291, and I thought I would begin my testimony with a short quiz. Who is the most unpopular Member of Congress and what is their most unpopular bill.

Mr. Markey, I thought you would have an answer. Taxachusetts, that was the State. No. The answer is Congressman Schnell, and his bill H.R. 602P, and that is the final answer. There is no such congressman, and there is no such bill. But if you are like me, you have received thousands and thousands of letters and e-mails saying that bill in fact will be up in the next 2 weeks beginning 1½ years ago, and they are outraged that the Congress is going to take this bill up. And of course that is a rumor that is only false.

Around the same time another e-mail campaign suggested that the FCC was going to impose a permanent access charge on Internet use and again our constituents flooded our offices with e-mails to express their outrage. Upon closer examination the FCC was asked if it was going to authorize a permanent access fee on Internet use, and in reply the FCC stated it had no plans at the present time to authorize such a fee.

While I am glad that the FCC has no plans at the present time to impose such a fee, I am troubled by the fact that there is nothing to prevent the FCC from doing so today or tomorrow or the next day or the next, and that is why I introduce my bill, which so many of you have cosponsored today.

My bill stops, it will prevent a stop watch from being placed on the Internet so that our constituents are not charged by the minute when they surf the Web or when they e-mail their friends, families, customers or even us for that matter. And after all, our constituents already are paying for phone service in a monthly fee to their Internet service provider. Clearly if our constituents were charged by the minute when they surfed the Web or e-mailed this would drastically increase the cost and dramatically inhibit their use of the Internet. This would impact folks who communicate by e-mail,

particularly with families with children or spouses in the military overseas or children who are in college far away from home, families who are scattered across the Nation and around the globe and seniors on fixed incomes who have finally begun to communicate by e-mail to their grandchildren.

We cannot let this happen, and my bill prevents it and I am pleased that most of you here today are cosponsors, along with 138 of our colleagues, and I am pleased that Governor Gilmore testified in support of this bill when he testified in front of this subcommittee last month.

More specifically, my bill would prohibit the FCC from imposing any access charge that is based on a measure of time for the support of the universal service, and as such my bill is delicately crafted to prevent Internet users from being swept into the current system of implicit subsidies that local and long distance telephone companies and their regulators have relied on to promote and preserve universal service without underminding the principle that phone companies need to be able to recoup the legitimate costs associated with providing services related to the Internet.

On a final note, given the rapid pace of telecommunication technology, I believe we must carefully consider how steps Congress might take today will impact or apply to future technology. In this regard I believe there are legitimate concerns that a broad interpretation of my bill could jeopardize the near future deployment of Internet telephony, which would enable people to use their computers to communicate by voice over the Internet.

To set the record straight, I would like to make crystal clear that my bill is not aimed at this type of voice telecommunication but instead at data communication. That is why so many of our constituents have e-mailed us over the last 1½ years.

Furthermore, I recognize that the dazzling advances in technology have the potential to blur distinctions between data and voice, making our attempts to legislate all the more difficult, but I firmly believe that we can craft a proposal based on my bill which will accomplish our objective in a responsible manner.

Again, Mr. Chairman, I appreciate the opportunity to come and testify before my former subcommittee and I look forward to being back in the future. I yield back the balance of my time.

Mr. TAUZIN. The Chair thanks the gentleman for his presentation.

Who is this Herr Schnell?

Mr. UPTON. He is not a Republican. I know that.

Mr. TAUZIN. Is that some rumor on the Internet?

Mr. UPTON. It is.

Mr. TAUZIN. That he is going to impose modem fees?

Mr. UPTON. 602P. The word is—and I read and sign all of my legislative mail, and I have received well over a thousand e-mails from my constituents telling me that in the 2 weeks we will be taking up 602P offered by Congressman Schnell and hope that I will vote no, and I have been receiving that message since January of last year. I think we did once have a Congressman Schnell but not during my service in the Congress.

Mr. TAUZIN. Mr. Markey and I were commenting about the most unpopular congressman. It was not that we didn't have a ready an-

swer for you, we had too many ready answers. Obviously there is no Herr Schnell. There is your bill which literally is aimed at targeting protection against access fees for regular data services on the Internet.

You heard my comments about my concern. Other members expressed it, that this bill not settle, not get into the question of whether or not when the Internet becomes the vehicle for telephony, whether the ISPs who provide telephony services to people should or should not be required to contribute to the maintenance of the networks and the universal service systems that support telephone networks.

Do you share those concerns?

Mr. UPTON. I want to make it absolutely clear that you are correct and we have not had a chance to have that colloquy until now, but my bill is aimed solely at data transfer. As an example, my brother-in-law serves in the Air Force. He has been all over the globe, now in Japan. As he has been on his missions it has been wonderful for me to communicate in terms of data that we send back and forth using e-mail. This legislation looks at that transfer of communication, not at voice. My bill should not be construed to incorporate voice as part of this bill but solely on the data end of things.

Mr. TAUZIN. I think it is important for all of the members and the listening audience to understand that this is not just a fictitious problem, there are currently freephone.com, and I understand AT&T has BroadNet 2 Phone, which is an effort again to get into telephony on the Internet, and those forms of service, voice communications on the Internet indeed are upon us and so it is a consideration we have to somehow make in the final passage of this bill that we don't get into that very thorny issue.

I also want to point out to members that one of the problems is that the FCC defined ISPs being end users not as providers, and so it complicates the issue of what happens when an ISP begins providing telephone service on the Internet as to whether or not it is subject to access charges for the support of universal service and the maintenance of telephone networks.

I want to congratulate you on your good work and also tell you that we intend to expeditiously move this legislation, and ask your help in making sure that the language is designed in such a way that it does do exactly what you intended in the bill.

Mr. UPTON. If we need to make further clarification, I would be glad to accept that language. I appreciate your support.

Mr. TAUZIN. I yield to the ranking member, Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman.

I have this hearing that we conducted in the subcommittee on October 2, 1987, back long ago when I was chairman of the subcommittee.

Mr. UPTON. I was in junior high school.

Mr. MARKEY. The subject of the hearing was flat rate versus per minute charges, and the Federal Communications Commission was proposing to essentially move to a per minute system and so the subcommittee held a hearing. At that point we had it at the Tip O'Neill Building in Boston, Massachusetts on this subject with all of the concerned parties at the time.

Chairman Dennis Patrick of the FCC was proposing that we move toward the per minute approach and obviously at that point in time, as I will go back to my opening statement, less than 1 percent of Americans now use information services and 95 percent of households with personal computers lack the modems that allow them to access those services. The industry rests on a precipice, and these ill-timed FCC proposals could push it into a distant future. So after our series of hearings, we will convince them to flip their perspective and they ruled in the opposite direction.

Mr. TAUZIN. You are the man, Markey.

Mr. MARKEY. Even a blind squirrel finds an acorn once in a while. I am taking credit only for ensuring that the issues of today are put in the proper context of the long story line that they embody. And as we sit here today, we recognize the success of those policies. Let's take credit. This is not something that happened by accident, you know. The Internet actually had to be voted from the public sector to the private sector by the Congress. We had to push it over there after it was constructed by BB&N in my congressional district. So I am very proud of that and to a certain extent that is why those hearings were held because it was being constructed in my district.

The question now is as it becomes much more of a ubiquitous technology and it can be used for telephony, and since I continue to oppose moving from a flat rate to a permanent basis, is it appropriate for us to look at a per line charge in order to make sure that there is some contribution which is made to the universal service pool. It could be relatively modest per month, but at least it would ensure that all sectors were contributing to the subsidies that go to rural America.

My concern is that this rural America subsidy is something that I think most members want to protect and we want to make sure that there is some fairness in this application. So how would you look at for example per line—maybe $1 or $2 per month per line charge as a way of ensuring that there is some aid given to rural subscribers?

Mr. UPTON. I would just note as we have looked at the explosion of the Internet, last week I visited a fifth grade school outside of Kalamazoo and I asked the students, 120 kids, how many kids there know how to use the Internet, I don't think there was a single hand that stayed down.

I know that the practical experience is that as people have their home computer and whether it is AOL or whatever provider that they might have, Internet provider, it is now the most folks are beginning to get two lines. My 8 and 12 year old when they were on it, pick up to call somebody and if you had only one line, it disconnected the whole system. And after a couple of crashes like that, like a lot of households we now have two lines. We have a line solely dedicated to the computer. Line charge and the taxes as part of that is——

Mr. MARKEY. In terms of whether or not a telephone call is made on a circuit switch network as opposed to a packet switch network because if you ask those kids how many have phones, they are going to raise their hands. And we want to maintain the universal accessibility to phones in rural America and that is the central

issue. How do we maintain that quality rural telephone service and who should be subsidizing it. Should it just be my father, the retired milkman, or should there be some role that the pack and switch network if it is going to provide telephone service also play but not moving to a per minute charge system but rather looking at perhaps a per line—again, I am just raising the question. And more to look for a way to effectively ensure that there is rural telephone service that is maintained at a high quality and that it is done on an equitable basis. Are you open to that per line charge, even if it is modest?

Mr. UPTON. As I look at all of the people on our street, whether in Michigan or here, there are many people that have the second line and they are paying the taxes on that second line and they are paying the additional charge.

Mr. MARKEY. If two companies are providing telephony and one is using the Internet to provide it and one is using the traditional system, should one type of company be favored over the other one in terms of whether they have to subsidize the telephone service to rural America?

Mr. UPTON. My bill it is clear that we are looking at data transfer, not at telephony. I can see the case where the telephone provider might be in competition. There are ways that you can circumvent and get free voice long distance. I can see where that puts the existing folks at a real disadvantage, and that is why my bill is targeted only at data. But I don't know—I will leave—I don't pretend to be an expert on the per line charge. I was not part of the hearings back in 1987.

Mr. MARKEY. Well, in fact it was. To the extent to which we were trying to again—the analogy here is that at that point in time there was only 1 percent usage and it was the upper white middle class.

Mr. UPTON. I am surprised it was that high, 1 percent.

Mr. MARKEY. And 90 percent had college degrees, and without a decision at that point that was made to go to flat rate pricing that would lead to a faster democratization of access to the technology, I don't think that we would be having this discussion here today. But we have this kind of historical artifact, the rural subsidies of the telephone. It is all part of that larger discussion. It is very difficult to separate it in terms of what the 1s and Os mean in the digital era in the transmission of information out into the rural parts of the country. I just raise it to see if you have some thoughts on it.

Thank you, Mr. Chairman.

Mr. TAUZIN. I thank the gentleman. The Chair recognizes Mr. Largent for a round of questions.

Mr. LARGENT. Mr. Upton, I just have one question. How do you respond when people talk about the diversion of tax dollars, I guess, or the loss of tax revenue to local, State, city municipalities as a result of the e-commerce which has taken place over the Internet?

Mr. UPTON. With regard to Internet sales?

Mr. LARGENT. Yes.

Mr. UPTON. The way that I respond to it, I look at our State, our Governor has done a terrific job in cutting taxes and it has been

the No. 1 job creator in our State in probably the last 3 years. Income taxes have been cut. Our State has a nice problem right now of having a budget surplus. The way that I respond to folks that would like to charge for products over the Internet because of the unfairness of our 6 percent sales tax versus none is to make things more competitive I think our State ought to look at lowering the sales tax. We are awash in cash. That ought to be a proposal on the table so that our bricks and mortar operations to be more competitive with the sales that they are competing with, so they can lower that tax and so they are in better competition, whether it is automobiles and books or anything else.

Mr. LARGENT. I yield back the balance of my time.

Mr. TAUZIN. I thank the gentleman. The gentleman from Tennessee, Mr. Gordon, is recognized.

Mr. GORDON. Mr. Upton, do you have an income tax also in Michigan?

Mr. UPTON. We do and our Governor and State legislature have just reduced that. It is coming down to under 4 percent now.

Mr. GORDON. I think probably a lot of the surpluses that we are seeing in various States are not a function of the sales tax that is fairly inelastic but rather those that have income taxes at this time of great prosperity. That is the reason that I think the tax coffers are swelling. As my friend from Texas mentioned, Texas and Tennessee only have a sales tax. We are somewhat at a disadvantage in that regard.

Mr. UPTON. While I am supportive of the effort to extend the moratorium and I have had long discussions with my colleague, Mr. Cox, on this, my bill doesn't address that. But while I do support it, again, I look at our State. We have cut our property taxes by a third. It has been terrific. It is one of the reasons that our State has prospered to the degree that we have. We have had a Governor and a State legislature that has thought that cutting taxes would in fact create growth, and that is exactly what has happened.

Mr. GORDON. Thank you.

Mr. TAUZIN. Thank you, Mr. Gordon. The gentleman from California, Mr. Rogan, is recognized.

Mr. ROGAN. Mr. Chairman, I want to thank you for calling this hearing and also especially thank our colleague from Michigan for his presentation today. I am fully in support of the premise under his bill.

Just a quick question. I don't know if you have seen this before, Mr. Upton. I read a couple of years ago that one of the premises underlying the creation of a sales tax was this: That because a business, say, that opens its doors on Main Street would have to have responsiveness from the local community with respect to police, fire, parking spaces, meter attendants, and so forth, that the justification for the sales tax was to help subsidize the cost of those additional expenses.

Have you in your research on this bill run into language that would indicate that there was justification for that?

Mr. UPTON. I agree with the gentleman's premise, which is one of the reasons why I support the moratorium on no sales taxes on

the Internet. In fact, it is very much like a catalog sale where, again, you don't have a presence in that particular State.

The point was made to me during our 2-week break that with different products in different States it is terribly complicated in terms of what is taxed and what is not. As I read the New York Times here in Washington, I see they are talking about certain weeks in New York City where they are not going to have a sales tax on any clothes that are sold in the city as a special deal to get people to come into the city. How do you factor that in?

There is a difference in the sales tax rate in New York City between a bottle of pickles that is in glass and a bottle of pickles that is in plastic. Those tax codes are terribly complicated. I don't know how you end up getting the right thing.

You have to remember, too, as you buy something, as one buys something on the Internet, they usually have a delay of 1 day to 5 business days in terms of the delivery of the good. That is somewhat of an inconvenience versus if you are going to buy a tennis racket on the Internet versus going to Sports Authority, where you can actually hold it, see it and take it with you when you leave.

And there is the real thing about the village or the community that gets the money back from the sales tax when they do not have to provide police, fire, sewage, all the other services that a municipality does.

It is sort of interesting, we have one small community in my district, a two-traffic-light town, that is looking at an e-commerce company coming in. They are going to provide 300 or 400 jobs if it gets fully up, which is terrific. They will pay the taxes for those Michigan residents that buy that particular service.

In a lot of cases, e-commerce companies have in fact expanded because all of a sudden you have the universe now at your sales door instead of just the folks in your particular community. So I buy the argument that we could extend the moratorium for all those reasons that you suggested.

Mr. ROGAN. I know that the question of sales taxes outside the four corners of your bill, it all goes to the vitality of the Internet, and precluding the FCC from imposing access charges is one of the key building blocks to maintaining the viability of the Internet. Once again, I want to commend you for your leadership.

Mr. Chairman, thank you again for holding this hearing. I yield back the balance of my time.

Mr. TAUZIN. Thank you.

The gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you, Mr. Chairman.

I am glad you introduced the bill, Mr. Upton. I am glad to be a cosponsor. All of us have received those letters. Maybe, Mr. Chairman, what we ought to do is have a hearing and just maybe subpoena and put that on the Internet. I don't know how long your letters have been coming in, but ours have been coming in at least 6 or 7 months.

Mr. UPTON. Within the next 2 weeks you are going to have that bill on the floor.

Mr. GREEN. That has been the last 6 months, and I am still looking for Mr. Snell.

Mr. TAUZIN. He serves in a virtual Congress, not the real one.

Mr. GREEN. Just so they cannot pass real laws.

I yield back the balance of my time. I am glad you introduced it, Fred.

Mr. UPTON. I appreciate your early cosponsorship of this measure, as well.

Mr. TAUZIN. There were 16 members of our full committee who were original cosponsors. There may be more now. I congratulate the gentleman on his good work.

The Chair would, first of all—I think the gentleman from California, Mr. Cox, is recognized next.

Mr. COX. Thank you. I am not sure. You were going to recognize the gentleman from Massachusetts.

Mr. TAUZIN. I apologize to the gentleman.

Mr. COX. Thank you, Congressman Upton, my colleague, for bringing us this bill and for giving us the opportunity to solve a big problem before it actually happens.

This, like the Internet Tax Freedom Act, is a rescue just in time. It is a lot easier to prevent these bad things from happening before they really do occur. And, of course, this is an area where, so far, the taxes that you are talking about have not been imposed upon American consumers, but we are worried that because of the regulatory power that was given to the Federal Communications Commission in the 1930's that—at a time, of course, when the Internet was not even a gleam in anyone's eye, that they might try and interpret that ancient authority to impose new taxes now in the 21st century.

I just want to run some numbers that my staff has given me by you and see if this comports with your understanding of just how bad the problem would be if the FCC were allowed to do that.

The average Internet user spends 22 hours a month online. That is our latest data. If the FCC forced the average Internet user to pay the access charges that your bill would prevent, at the current average rate of 2½ cents a minute that works out to $33 a month, or about $400 a year. Is that your understanding of just how big this tax would be?

Mr. UPTON. It is. It is.

Mr. COX. Wouldn't this rather obviously price Internet services out of the range of many, if not most, Americans?

Mr. UPTON. I think it would. And, again, a lot of us have invested in a second line at our house. Your kids are grown up now as well. If you have only one line, you can lose the whole connection and you have to go back to the beginning again.

So we have invested in an extra line, we are paying taxes on that extra line and the charges that are assessed as part of that, and then to say you are going to pay another $400 a year per family on average is going to put a lot of families out of touch with each other.

Mr. COX. You mentioned the second line. Every phone line in the House is already subject to this $3.50 Federal subscriber line charge.

Mr. UPTON. Yes. So a lot of us are already paying twice.

Mr. COX. Now, in 1997, is it not right that the FCC pushed through another tax on a second line, so you pay an extra tax on the second line?

Mr. UPTON. Yes. The second line is actually, as I understand it, more expensive than the first line.

Mr. COX. It is $6 a month for the second line, is that right? So that amounts—to the extent that people are adding second lines so they can connect their modems, that amounts to a modem tax. It amounts to a modem tax in that same range of hundreds of dollars a year.

Mr. UPTON. Yes.

Mr. COX. Does your bill address that?

Mr. UPTON. It does not.

Mr. COX. Mr. Chairman, I hope that as soon as we enact Mr. Upton's bill that we can now address this next problem that he has pointed out for us and get rid of that horrible second line tax, the modem tax, which discriminates against Internet usage at a time when a lot of us are listening to the President, the Governors, and everyone else complain about the digital divide.

I yield back.

Mr. TAUZIN. I thank the gentleman.

The Chair recognizes the gentleman from Ohio, Mr. Sawyer, for questions.

Mr. SAWYER. Thank you, Mr. Chairman. I just want to take a brief moment to thank our colleague, Fred, for doing the work that it took to bring this bill to this point. I look forward to seeing it on the floor.

Mr. UPTON. Thank you.

Mr. TAUZIN. I thank the gentleman.

The Chair now recognizes the gentleman from Maryland, Mr. Ehrlich, for a round of questions.

Mr. EHRLICH. I could use any number of one-liners, but I won't. Thank you, Mr. Chairman.

Fred, just real briefly, first of all, you have done great work here, as we all know. Getting back to two questions that have been asked with respect to this great philosophical issue about sales tax and use tax and fairness and an even playing field you were asked I think by Mr. Largent, how do you respond to the equitable type argument that is used?

Isn't it fair also—you also touched on this, and I think this is an underanalyzed part of the e-commerce explosion—these entities make things. They are located somewhere. You have a new one in your district. Obviously, to the extent that occurs, it is new products, it is new businesses, it is new property taxes, new income taxes paid by employees, payroll taxes, the whole nine yards. That is, I think, an underanalyzed part of the debate with respect to how equitable this whole thing is in keeping the Internet explosion going.

Would you comment further on that? I find it fairly compelling, and nobody ever talks about it.

Mr. UPTON. I would make a point which I think uses your district. I play tennis with Chairman Bliley every Wednesday, and he whipped our butts this morning, despite my getting a new pair of tennis shoes from your district, Holabird Sports. Is that in your district?

Mr. EHRLICH. Congratulations. That is right.

Mr. UPTON. Catalog sales. I did not pay tax on it because it was sent—I don't live in Maryland, and it was sent from your district. I think e-commerce ought to be treated the same as catalog sales. They don't have a bricks-and-mortar structure in Michigan, and they sent it UPS, and they are pretty good shoes that I got. That is the type of system that we ought to be using. It is the same thing. It is an exact parallel with catalog sales as it is with e-commerce.

If for some reason all of a sudden we put up that road map of pickles, whether it is in a glass jar or plastic, or this is the reason New York City does not have a sales tax on this week, it is—I have seen the statistics someplace, it is 6,500 different regulations on sales taxes. There is no way people are going to meet that. That is not why they are buying the shoes or racket or whatever, it is not because of the sales tax, but it in fact will inhibit the growth of what has really helped a lot of businesses and consumers, whether they be in urban or rural areas.

Mr. EHRLICH. Certainly it would not apply to shoes, but the fact is new products are introduced as a function of e-commerce. That is, I think, something, Mr. Chairman, we need to place in the course of this discussion, the context of this discussion.

I yield back.

Mr. TAUZIN. I thank the gentleman.

The gentleman from Illinois, Mr. Shimkus.

Mr. SHIMKUS. Thank you. I will be brief.

I want to thank my colleague from Michigan and note that, since I think today is Tax Freedom Day, it is quite appropriate we are talking about this. We will just focus on the fact again, why is it Tax Freedom Day? We cannot just take our income tax and divide out the amount of days and figure out how long we work for the Federal Government because we have all these hidden taxes.

If we can be clear and honest and then let the elected policy leaders elected by their constituents debate how best clearly to identify the amount of revenue they need to fund the services that the constituents desire, we would be much better off as a Nation.

I see this as a way that we can continue to address this. E-commerce may force us to do it. I appreciate your work.

Mr. UPTON. Just a comment, if the gentleman will yield for 1 second. Our reading of the Constitution is only the Congress can tax or spend. Yet we have seen a history now over the last couple of years of the FCC putting their elbows out and taking that authority. This takes it away and puts it where it ought to be. We ought to decide here whether to tax access to the Internet. If we decide not to tax it, it should not be done, versus allowing someone to tax it before we have to try and stop it.

Mr. SHIMKUS. The price of freedom is eternal vigilance. I appreciate that.

Mr. TAUZIN. I thank the gentleman.

Mr. MARKEY. May I be recognized, Mr. Chairman?

Mr. TAUZIN. You may be recognized to strike the last word.

Mr. MARKEY. Thank you.

I have just been listening to this discussion with Mr. Ehrlich. The gentleman from Michigan is correct that he does not owe any taxes to the State of Maryland, but in purchasing that pair of

sneakers he does owe Governor Engler taxes. You do owe taxes on that.

Mr. UPTON. I have them sent to the District of Columbia.

Mr. MARKEY. You owe taxes to the District of Columbia.

Mr. UPTON. Not on a catalog sale.

Mr. MARKEY. Yes, you do.

Mr. UPTON. I will pay it.

Mr. MARKEY. I know you are quite proud of purchasing it in a way that did not acquire your actual taxes, but you do owe the taxes there. I think that is a misunderstanding that a lot of people have about the Internet.

Mr. COX. Will the gentleman yield?

Mr. MARKEY. I will be glad to yield.

Mr. COX. The use tax obligation is the mirror image of the sales tax obligation, but it should be added that the Governors are the first to tell us that they are about as good at enforcing use taxes against individual consumers as the Federal Government is at enforcing the penalties for not filling out all the questions in the long Census form.

Mr. MARKEY. If I can reclaim my time, although Governor Gilmore was here testifying taking one position several weeks ago, as we know, Governor Engler takes just the opposite position. Although he does take that position, I don't think it is as a native of Massachusetts. I think he is just generically a Governor, and I think that is the basis of his position. You do owe him or the District of Columbia the tax money.

The other point that I was going to make is that the reason I raised that question about the voice versus data is that in your bill, as you define it, you say, "The Commission shall not impose on any interactive computer service." That, of course, would mean voice and data. So your bill actually——

Mr. UPTON. It needs to be clarified.

Mr. MARKEY. That is the point I was making, just going back to your own statement. You do include voice in your own bill.

Mr. UPTON. If the gentleman will yield for a second, I introduced this bill 1½ years ago or so, and at that point it was not an issue. It has been rightly raised, and I am absolutely in favor of correcting it to define it the way that I indicated this morning.

Mr. MARKEY. I would just add that, looking at this rural subsidy that urban America does not provide, I am trying to provide an equitable answer.

Mr. TAUZIN. I think it is important at the conclusion of your testimony, Fred, to point out we are going to hold here discussion on the moratorium bill as well, but that does not prohibit the collection of sales taxes or use taxes on Internet sales any more than they do on catalogue sales. That is a big confusion. I had to straighten it out everywhere I went in my district this last week.

The difficulty, as Mr. Cox pointed out, is that there is a huge difficulty, not only a constitutional question of nexus but a practical difficulty, in collecting use taxes. Governor Gilmore, his State tries to do it with a line on the income tax form that asks the income tax reporters in Virginia to go ahead and divulge all the purchases they have made from out of State. I would question how many people use those lines.

It is a very complex and difficult area, and we will probably have to have some kind of an agreement of the States and the counties on how to manage the system in the future, just as we did on uniform sourcing on cellular telephone taxes, the bill we just passed out a couple of weeks ago from this committee.

Fred, thank you again.

I also want to point out, by the way, Mr. Cox, and you made mention of the second line charge, that the Progress and Freedom Foundation has an excellent report out on telephone taxes, and I would commend it you to read, where the Foundation estimates a 20 percent shortfall on poverty access to the Internet because of the already high level of telephone taxes, a level that the State, local and now the Federal Government, through the Spanish American War tax and the FCC's own system of taxation, levies.

Mr. UPTON. Dick Armey said this morning that the Spanish Ambassador told him that they are not coming again, I would note.

Mr. TAUZIN. Again, I think we will have an opportunity to deal with that tax. I hope we will.

Mr. COX. Mr. Chairman, I wonder if I could ask for one point of clarification.

Mr. TAUZIN. The gentleman is recognized to strike the last word.

Mr. COX. We have had some good interchange about the portion of the bill that might direct itself toward Internet telephony as against Internet transmission of data.

Our colleague from Massachusetts asked you whether or not you believe that packet-switched telephony should have an advantage when it comes to these taxes. I think everybody agrees that we ought not to put the thumb on the scale in favor of one kind of telephony or another, but what I am concerned about and what I hope I am not hearing is that we might impliedly be directing the FCC to impose these taxes on Internet telephony, which I sure as heck don't want to see, and I hope nobody here wishes to see that.

The model for the future must be the Internet, not the old system of the 1930's when we had long land lines subsidizing local service. That was one thing. Now we have got all these different competing forms of telecommunication. That is the world we intended to create with our act a few years ago.

I think it is very, very important for us, for example, not to encourage the FCC to get into the business of trying to get inside the packets and figure out how much of it is data and how much is voice. It is all zeros and ones. It looks the same. It is, technologically, enormously challenging. It involves privacy rights if they are going to use other means to find out what is in your communications.

So I get very concerned when I hear about the importance of these subsidies and the importance of these taxes and the importance of this complexity of this old system that we adopted many decades ago without the Internet in mind, because it is not necessary for a solution to the problem of the digital divide, it is not necessary to achieve universal service.

I will just leave you with this fact, and I will subside entirely. It is that today in America there is a greater penetration of the population with television than there is with telephone. We have universal service, taxes and subsidies for telephones and not for

televisions. More people, more families, more poor people, have televisions than telephones, notwithstanding this elaborate system of taxes and subsidies and so on. You can see why when you figure out how regressive all these taxes are and how counterproductive the whole system, the model should be the Internet for the future.

I hope we are very careful when we draft this legislation and do not encourage it.

Mr. TAUZIN. If the gentleman will yield, I simply want to point out that we may come to a point, hopefully sooner rather than later, when telephone companies are permitted to cross the old lines and offer full-blown broadband Internet services to everyone in this country in competition with the AOLs and AT&T cables, that second wired competition that I think all of us want to see 1 day.

Maybe at that point in time we can reach that point with a new Internet service, including voice transmissions, which I am told is going to be a loss leader, almost given away free, that that will no longer require these kinds of charges. The problem is in the interim. While I agree with the gentleman that we ought not to direct the FCC on how to resolve it, Mr. Markey and Mr. Upton had a dialog on potential ways to resolve it, but, in the interim, what do you do when someone uses the current system of Internet to provide telephony using the local networks, when other people who use the local networks through regular telephone service are required to support those local networks, and an ISP—under the current definition ISPs do not? That is a real problem.

Mr. MARKEY. Would the gentleman from California yield?

Mr. TAUZIN. Sure.

Mr. MARKEY. I share the gentleman's concern about access charges, and for 20 years I have been trying to do my best to do away with access charges for the circuit switch network. I agree with that goal. Obviously, I believe in that. I am looking very close at this rural subsidy. I believe it is very bloated.

But if we are not going to eliminate it, if we are—if we want to maintain a subsidy for rural America, my only point here is that there should be some understanding that the service that is provided, whether it be packet switch or circuit switch, really does not make any difference in terms of the consumer.

I can understand why back in 1967 AT&T, when it was offered by the Federal Government, the contract to build the packet switch network, said no. So did IBM. They had a perfectly good circuit switch monopoly. So that is why BB&N up in Boston had to build it.

But the point today is that when you look at it in terms of its practical application, that there really is not a difference in terms of the consumer's benefit but there is a difference in terms of the access charges that are imposed.

I have always believed that these access charges are bloated. I would like to get rid of them or reduce them down to an absolute minimum, but I would also like to maintain some subsidies for rural America. If we are going to do that, then we are just going to have to find a way of ensuring that there is some equity. That is the only discussion I am trying to raise. I want to work with the gentleman toward achieving that goal.

Mr. TAUZIN. If the gentleman would yield once again, I would simply point out that the day when access charges no longer become relevant or important is the day when the local telephone networks finally complete their 271s and they are into full-blown telephone competition or we are smart enough, at least in these advanced services areas, to free them from these old LATA line restrictions which many of you have joined with me in an effort to do. I hope we do it sooner than later.

But doing that may be the prerequisite, the first thing you do, in order to get to that point when you can eliminate all access charges, and then you don't get into a fight as to whether or not you ought to have them for ISPs and not have them for telephony.

The sooner we reach that world, frankly, I think the sooner the folks in rural America are going to be better off, because they will have the opportunity to get distance-irrelevant communications going, just the same way the Internet provides distance-irrelevant services today.

Mr. MARKEY. Mr. Chairman, the difference between telephone and television and why a television is more ubiquitous, when you buy a television, from then on service is free.

Mr. COX. Actually, it costs $1 billion in subsidies to put the satellite up so then you can get pay TV.

Mr. MARKEY. That is another subject. That is a sore point that the gentleman and I agree upon 100 percent in terms of pay TV. But in terms of——

Mr. TAUZIN. That is a different hearing.

Mr. MARKEY. In terms of just the television itself, you buy one, put it in your living room, it is free forever, unless you want to subscribe to the satellite or cable TV. But when you buy a phone, you are paying for that service from day one on. So it makes sense that everyone would have a television in the home because it is free; and, with a phone, it could be a lower percentage of the population.

Mr. TAUZIN. For quick clarification, there is also a difference, however, between services that are provided by wires and services that are provided over the air, the broadcast spectrum. The notion that somebody had to lay a wire down to a rural community where very few people live, cable or telephone wire, causes real cost problems and economic considerations. So it is a good discussion.

I yield to the gentleman from California.

Mr. COX. I just hope, Mr. Chairman, that we recognize that if we take—this is not what Congressman Upton started out to do, and if we take the step either wittingly or unwittingly of encouraging the FCC to lay a tax on Internet telephony, that that is much more than the nose of the camel under the tent. That is the determinant of the FCC's becoming the regulator of the Internet and its complete morphing from the Federal Communications Commission into the Federal Computer Commission, a step I dearly wish never to see.

Mr. TAUZIN. I join you in that concern.

Mr. Upton, thank you so much for your patience, sir. You can see the way, since you have left, we have really gotten excited. I think you ought to come back.

For the second panel, we have Mr. Peter Lowy, co-president of Westfield America in Los Angeles on behalf of e-Fairness Coalition;

Mr. Grover Norquist, president of Americans for Tax Reform in Washington, DC; Mr. Harris Miller, president of Information Technology Association of America here in Arlington; and Mr. Leroy Grey, president of RAVEN-Villages Internet, a small ISP run in West Virginia.

Gentlemen, welcome.

We will begin with Mr. Peter Lowy, the co-president of Westfield America. Gentleman, your written statements are part of our record. We have them. You have 5 minutes to summarize the high points of your testimony.

Mr. Lowy.

STATEMENTS OF PETER LOWY, CO-PRESIDENT, WESTFIELD AMERICA; GROVER G. NORQUIST, PRESIDENT, AMERICANS FOR TAX REFORM; HARRIS N. MILLER, PRESIDENT, INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA; AND LEROY E. GREY, PRESIDENT, RAVEN-VILLAGES INTERNET

Mr. LOWY. Thank you, Mr. Chairman. I am Peter Lowy, president of Westfield America and founding chairman of the e-Fairness Coalition.

I would like to thank Chairman Tauzin and Ranking Member Markey for providing me the opportunity to speak on this important issue.

The e-Fairness Coalition represents the real estate industry and 1.5 million retail stores, ranging from Cody's Booksellers in San Francisco to national retailers such as Wal-Mart and Sears, as well as one out of every five American workers nationwide.

Taxation of the Internet involves three interrelated issues: taxes on Internet access charges, multiple and discriminatory taxes, and collection of sales and use taxes on retail sales made on the Internet.

We oppose H.R. 4202 and H.R. 1291 because we believe there should be a fully integrated solution with regard to taxation and the Internet, not a piecemeal one that does not address an equitable collection of sales taxes on retail sales.

While there is broad agreement on the issues of access and on multiple and discriminatory taxes, there is clearly no agreement with respect to sales and use taxes and e-commerce. If Congress passes bills addressing the first two issues, there is no incentive to address the most critical and most difficult issue, which is to provide a level playing field for the collection of sales taxes.

The States are currently working on simplifying sales tax rules Nationwide. An extension of the moratorium will stop the momentum gained in solving the complex issues of sales and use tax collection.

There should be no rush to extend the current moratorium as it does not expire until October 21, 2001. We have 16 more months to consider permanent solutions to all of these issues.

Current law provides for a blatantly unfair playing field where brick and mortar retailers collect sales taxes, but their online competitors are exempt from collection responsibility. As tax-free online consumer sales grow, estimated to be in excess of $100 billion in 2003, the States and cities will look for other revenues to offset un-

collected sales and use tax from sales that have migrated to the Internet.

The Nation's Governors also oppose a simple extension of the moratorium. On April 12, 2000, a bipartisan group of 36 Governors sent a letter to the congressional leadership urging rejection of the report of the Advisory Commission on Electronic Commerce and expressing support for a level playing field. Five additional Governors sent their own letters expressing similar concerns.

The message of the e-Fairness Coalition is simple. We support a level playing field so all retailers—in-store, catalog, and online—have the same sales and use tax collection responsibilities.

We do not support new taxes on Internet sales. Sales made over the Internet are already subject to sales and use taxes, as we saw earlier.

Under current law, if a remote retailer such as an Internet seller or a catalogue company, has a physical presence or nexus in the State of the buyer, the retailer is required to collect sales tax on behalf of the State where the buyer is located. If it does not have a physical presence, it does not have to collect sales taxes, but tax is still owed by the consumer.

We currently have a situation where online companies fit into three categories: pure play, pure Internet retailers that do not have physical presence in most States and do not collect sales taxes; integrated clicks and mortar, retailers which have both physical and online stores. Since many retailers have a physical presence in most States, they are required to collect sales tax on in-store and online sales. Then, physical presence with no nexus. Many retailers with physical and online stores are setting up a corporate structure in a way that does not require the collection of sales or use taxes on online sales. In this arrangement, the online business is set up in a separate subsidiary that does not have nexus and is therefore not required to collect sales and use taxes. Indeed, the expanded nexus provisions included in the ACEC report would formalize this situation.

If Congress does not address the current inequity in sales tax collection rules, more companies will create corporate structures to avoid sales tax collection responsibilities. While corporations would like to integrate their physical and online stores, discriminatory tax policies are forcing retailers to separate their online and in-store strategies.

The e-Fairness Coalition believes Congress should enact legislation encouraging States to adopt simplified sales tax systems. States that adopt the simplified systems should be authorized to require remote sellers to collect sales taxes.

Allowing States to require all retailers to collect and remit sales tax would expand the collection of taxes and enable States to lower taxes for all consumers. The best sales tax is broad-based and low.

Extending the moratorium and continuing the status quo will narrow the consumption tax base and lead to an increase in other taxes on business and individuals. Local and State governments may be forced to raise income, property, sales, or other taxes to make up for lost revenues. Without solving the sales and use tax issue, an extension of the moratorium could result in an increase in taxes to the consumer.

It is important to remember that sales and use taxes are consumption taxes, paid by the consumer to fund schools, police, roads, and other services that benefit local consumers. The retailer is merely the collection agent.

How a product is purchased, whether in-store or online, should not determine whether a consumption tax is paid. In either situation, the buyer receives the benefit from those public services. Congress should support efforts to level the playing field and provide all retailers with equal sales tax collection responsibilities.

No one wants to tax the Internet or provide discriminatory taxes on the Internet. However, extending the moratorium without addressing the equitable collection of sales tax is incomplete and counterproductive. Congress must address all three issues: access taxes, discriminatory taxes, and sales taxes. Our Nation's Internet tax policy should be fully integrated, incorporating a permanent solution for all three issues.

Thank you, Mr. Chairman.

[The prepared statement of Peter Lowy follows:]

PREPARED STATEMENT OF PETER LOWY, PRESIDENT, WESTFIELD AMERICA, ON BEHALF OF E-FAIRNESS COALITION

I am Peter Lowy, President of Westfield America, and Founding Chairman of the e-Fairness Coalition. I'd like to thank Chairman Tauzin and Ranking Member Markey for providing me the opportunity to speak on this important issue.

Westfield America owns interests in 38 major shopping centers across the country that are home to approximately 4,700 retail stores. In many communities, we are one of the largest contributors to the local tax base through the property taxes we pay and the sales taxes we generate.

The e-Fairness Coalition includes brick-and-mortar and online retailers, realtors, retail and real estate associations, and publicly- and privately owned shopping centers. Our Coalition represents 1.5 million retail stores ranging from Cody's Booksellers in San Francisco to national retailers such as Wal-Mart and Sears, as well as 1 out of every 5 American workers nationwide.

The e-Fairness Coalition opposes H.R. 4202, the "Internet Services Promotion Act of 2000" and H.R. 1291, the "Internet Access Charge Prohibition Act of 1999." Both bills provide prohibitions on FCC fees on internet access. Section 3 of H.R. 4202 also extends the current moratorium on taxes on Internet access and on multiple and discriminatory taxes on the Internet.

Taxation of the internet involves three interrelated issues. 1) Taxes on internet access charges; 2) Multiple and discriminatory taxes, and 3) Collection of sales and use taxes on retail sales made on the internet.

We oppose H.R. 4202 and H.R. 1291 because we believe that there should be a fully integrated solution with regard to taxation and the internet, not a piecemeal one that does not address an equitable collection of sales taxes on retail sales.

While there is broad agreement on the issues of access and on multiple and discriminatory taxes, there is clearly no agreement with respect to sales and use tax and e-commerce. If Congress passes bills addressing the first two issues, there is no incentive to address the most critical and most difficult issue, which is to provide a level playing field for the collection of sales taxes.

The states are currently working on simplifying sales tax rules nationwide. An extension of the moratorium will stop the momentum gained in solving the complex issue of sales and use tax collection.

There should be no rush to pass federal legislation at this time as the current moratorium does not expire until October 21, 2001. We have 16 more months to consider permanent solutions to all of these issues.

Problems with Current Law

Current law provides for a blatantly unfair playing field where brick and mortar retailers collect sales taxes, but their on-line competitors are exempted from collection responsibility. Because of the Supreme Court's 1992 *Quill* decision, the states cannot require remote retailers to collect and remit sales tax when the seller does not have a physical presence in the state of the buyer.

Extending the moratorium will allow an unlevel playing field to continue and unfairly subsidize Internet retailers at the expense of traditional retailers and the revenue needs of states and cities.

As tax-free online sales grow, estimated to be in excess of $100 billion in 2003, the states and cities will look for other revenues to offset uncollected sales and use tax from sales that have migrated to the internet. By not allowing the collection of consumption taxes on remote sales, the tax base will shrink and lead to increases in other taxes. Allowing sales tax collection on all sales will expand the tax base, which can lead to lower taxes.

In addition to the businesses represented by the e-Fairness Coalition, opposition to a simple extension of the moratorium is joined by a broad bipartisan group of the nation's Governors.

On April 12, 2000, a bipartisan group of 36 Governors sent a letter to Speaker Hastert, Minority Leader Gephardt, Majority Leader Lott, and Minority Leader Daschle urging rejection of the report of the Advisory Commission on Electronic Commerce. The Governors expressed support for a fair and equitable system to ensure that Main Street retail stores and Internet commerce enterprises can compete on a level playing field. Five additional Governors sent their own letters expressing similar concerns.

Support for a Level Playing Field

The message of the e-Fairness Coalition is simple: We support a "level playing field" so that all retailers—in-store, catalog, and online—all have the same sales and use tax collection responsibilities. Preferential tax policies and government subsidies for Internet retailers distort the market, and give Internet retailers an unfair competitive advantage.

Therefore, we support the enactment of federal legislation to allow states to treat all retail sales equally.

We do not support new taxes on Internet sales. Sales made over the Internet are already subject to sales and use taxes.

Under current law, if a remote retailer, such as an internet seller or a catalogue company, has a physical presence, or nexus, in the state of the buyer, the retailer is required to collect sales tax on behalf of the state where the buyer is located.

However, as I mentioned earlier, under the Supreme Court's 1992 Quill decision, if the remote retailer does not have a physical presence in the state of the buyer, the retailer cannot be required to collect sales tax.

Just because the retailer does not collect the tax does not mean that it is not due or applicable. When a retailer does not collect the sales tax, the buyer is required to pay a use tax to their home taxing jurisdiction. The use tax is not widely understood and compliance is very low.

Today, consumers are burdened with paying a use tax that most don't even know they owe. Under the traditional retail model—this amounted to a small impact on state economies. However, as e-commerce grows—the loss of sales tax created by the transference of sales to the Internet will not be offset by use tax unless we make that collection system simpler. The burden must be taken off of the consumer and replaced by the natural agent to collect these taxes—the Internet retailer. Under a simplified tax system, this will need to amount to a virtually zero burden system for the retailer.

We currently have a situation where online companies fit into 3 categories:

1. **Pure Play:** Pure Internet retailers that do not have physical presence in most states and do not collect sales taxes
2. **Integrated Clicks and Mortar:** These retailers have both physical and online stores. Since many large retailers have a physical presence in most states, they are required to collect sales taxes on in-store and on-line sales.
3. **Physical Presence with No Nexus:** Many retailers with physical and online stores are setting up a corporate structure in a way that does not require the collection of sales or use taxes on on-line sales. In this arrangement, the online business is set up in a separate subsidiary that does not have nexus, and is therefore not required to collect sales and use taxes. Indeed, the expanded nexus provisions included in the ACEC report would formalize this situation.

If Congress does not address the current inequity in sales tax collection rules, more companies will create corporate structures that avoid sales tax collection responsibilities. While corporations would like to integrate their physical and online stores, discriminatory tax policies are forcing retailers to separate their on-line and in-store strategies.

Misunderstanding about the Current Moratorium

There is a tremendous amount of confusion in the media and in Congress about the taxation of sales made over the Internet, and about the effect of the moratorium contained in the Internet Tax Freedom Act of 1998.

The current moratorium does *not* apply to sales and use taxes. The moratorium covers:

(1) taxes on Internet access, and
(2) multiple or discriminatory taxes on electronic commerce.

Within the 16 months left on the current moratorium, we believe that a permanent solution can be found. Congress should carefully consider this issue, especially since the Advisory Commission on Electronic Commerce failed to reach the two-thirds vote required.

Responsible Congressional Legislation is Necessary

The e-Fairness Coalition believes that Congress should enact legislation encouraging the states to adopt simplified sales tax systems. States that adopt the simplified systems should be authorized to require remote sellers above a sales volume threshold to collect sales taxes.

Providing a framework for simplification, and allowing states to require collection when the states achieve simplification is a reasonable and necessary step for Congress to take.

Extending the existing moratorium without including language allowing the states to require collection from all retailers will mean at least five more years of tax free sales for internet retailers, and a strong likelihood that internet sales will be given permanent preferential treatment.

Allowing states to require all retailers to collect and remit sales taxes will expand the consumption tax base and enable states to lower taxes for all consumers. The best sales tax is broad-based and low.

Extending the moratorium and continuing the status quo will narrow the consumption tax base and lead to an increase in other taxes on businesses and individuals. Local and state governments may be forced to raise income, property, sales, or other taxes to make up for lost revenues. Without solving the sales and use tax issue, an extension of the moratorium could result in an increase in taxes to the consumer.

It is important to remember that sales and use taxes are consumption taxes paid by the consumer to fund schools, police, roads, and other services that benefit local consumers. The retailer is merely the collection agent. How a product is purchased—whether in a store or on-line—should not determine whether a consumption tax is paid. In either situation, the buyer receives a benefit from public services (like roads, police, and fire). Congress should support efforts to level the playing field and provide all retailers with equal sales tax collection responsibilities.

No one wants to "Tax the Internet" or provide discriminatory taxes on the Internet. Extending the moratorium without addressing the equitable collection of sales tax is an incomplete and counter-productive exercise. Congress must address all three issues: 1) Access taxes, 2) discriminatory taxes, and 3) sales taxes. Our nation's internet tax policy should be fully integrated incorporating a permanent solution for all three issues.

Mr. TAUZIN. Next, the Chair will recognize Mr. Grover Norquist, president of Americans for Tax Reform. Grover.

STATEMENT OF GROVER G. NORQUIST

Mr. NORQUIST. Thank you, Chairman Tauzin, for the opportunity to testify here.

In keeping with truth in testimony I am here to represent Americans for Tax Reform. We do not now nor have we ever received money from the government—Federal, State, or local.

I served as a commissioner on the Advisory Commission on Electronic Commerce. My particular job there was to represent consumers, and we looked at three things, the first one being present taxes on the Internet.

The component parts of the Internet are extremely heavily taxed now by the 3 percent Federal excise tax to fund the Spanish American War that people are familiar with, but also the average State

and local tax on telecommunications, about 14 percent, about triple what the sales taxes on other industries are. Only tobacco and liquor are more heavily taxed than telecommunications.

Second were threatened taxes, these access charges we are talking about, discriminatory taxes that the moratorium presently puts off for 3 years but does not yet forbid.

The third one is the effort by some people to undermine the commerce clause and allow politicians in one State to tax businesses in another State, catalogue sales or electronic commerce.

We are here today to talk about two prophylactic bills, H.R. 1291, Mr. Upton's legislation to prohibit the imposition of access charges, and H.R. 4202, Mr. Ehrlich's legislation that would both prohibit those access charges by the FCC and extend the present moratorium for another 5 years. I think they are both extremely helpful and good bills. I understand there are certain concerns about some unintended consequences that I am sure the committee can deal with, but I think both of these are very good for taxpayers, very important for taxpayers. These taxes, of course, are paid by consumers, not by businesses, at the end of the day.

The Commission did actually address both of these issues; and, in a poll, 18 of the Commissioners agreed when I asked whether they would support both opposition to taxes and to the additional access charges. There was one fellow from South Dakota who was for all taxes at all times and we lost his vote, but there were 18, including the three Federal representatives.

The second one was a continuation of the moratorium, which even Governor Leavitt said he would support, although he has been an advocate in other areas for taxes on the Internet, but would support the extension of the moratorium.

I believe, however, that we should go beyond a 5-year extension of the moratorium to a permanent moratorium, which was the original effort by Congressman Cox and Senator Wyden in the Cox-Wyden legislation to permanently ban that.

Some people say, why not wait? It is a whole year or more away from when the moratorium lapses. People do not make last-minute decisions. People do plan ahead. It is important to decide now to make that a permanent moratorium. I think a 5-year moratorium is the least that we should do in that area.

I would also urge the committee to take a look at sunsetting the Gore tax. Right now the e-rate, the Gore tax, is set up for a particular purpose and an admirable purpose of wiring those schools that are not yet wired. Seventy percent are wired, 30 percent or something are not.

But I think it is important that we sunset that, or our grandchildren are going to be laughing about the Gore tax the way we are laughing about the Spanish American War tax. So let us set up a date certain or an amount spent certain, and when we have finished spending $10 billion or whatever it is that tax should lapse.

I would also suggest that we also have an audit of how the money has been spent.

The other issue that people have been focused on is the issue of taxing Internet sales or catalogue sales. Right now the commerce clause does not allow Utah to levy taxes on L.L. Bean in Maine.

This is a good idea. The commerce clause was not a loophole, as some Governors seem to think. The commerce clause was put in for good and sound reasons, and it is very important that a country founded on the revolutionary cry of no taxation without representation, just as we objected to Britain taxing America, I think we should object to Utah politicians taxing businesses either in Washington State or in Maine.

We have already seen the damage done when Alabama juries are able to rate Michigan businesses. There is no limit to what a jury would do to out-of-State businesses. There would also be no limit to what tax collectors from Utah would do to businesses in Maine. There is a limit to what Maine will do to L.L. Bean. There is no limit to what tax collectors in Utah will do to L.L. Bean. I think we need to protect against that.

I would urge you not to allow—what some people want to do is put politics over policy here. The two ideas put forward before this committee, this subcommittee, are extremely good. Prohibiting access charges, I hear everybody saying they are for that, and extending the moratorium there is strong support for. Do not let that be held hostage to those politicians who want to take a great leap forward and undermine the commerce clause, a discussion that we can have another time.

[The prepared statement of Grover G. Norquist follows:]

PREPARED STATEMENT OF GROVER H. NORQUIST, PRESIDENT, AMERICANS FOR TAX REFORM

Mr. Chairman, members of the Subcommittee, thank you for allowing me to present testimony today in support of H.R. 1291, the Internet Access Charge Prohibition Act of 1999.

Americans for Tax Reform supports this bill. H.R. 1291 would save consumers and taxpayers money by preventing the FCC from applying access charges to Internet Service Providers.

In addition to this bill, I would also like to take on the issue of Internet taxation in a broader sense. In recent weeks, the debate over electronic commerce has focused on exactly the wrong question; that is, "should the Internet be taxed?" Perhaps in a perfect world, this would be the right question. Right now, however, the building blocks of the Internet—phone lines, cable, and, in fact, all telecommunications—are already some of the most heavily taxed facets of the American economy.

The first excise tax on telecommunications was levied in 1898 to fund the Spanish-American War. The war is over. However, the federal tax remains and is joined by state and local excise taxes that average 14.1% and get as high as 28.6% in Texas, 24.5% in Florida and 15.8% in Washington, D.C. Just complying with existing law requires enormous resources. AT&T reports that it files 50,000 tax forms with government at all levels.

Some governors and big city mayors want to impose additional taxes on the Internet. They would overturn Supreme Court decisions that now protect interstate commerce. Part of the benefit of the Internet is its inherent usefulness as a commercial medium. Present law forbids Utah, for example, from forcing Amazon.com to collect Utah's sales tax when a citizen from Utah buys a book over the Internet. Adding additional taxes and regulations could present a dramatic threat to the growth of the Internet as a transaction medium.

Some Internet tax advocates, including Utah Governor Mike Leavitt, argue that the states need the extra taxes, that too much tax revenue is being lost, and that these additional taxes can be imposed without hurting the Internet or the Constitution. They are wrong on all four fronts. First, in 1998, the 50 states ended the year with $11 billion in surpluses. State and local government revenues have grown from 6.9 percent to 9 percent of GDP from 1968 to 1998—a period in which federal revenues fell from 20.5 percent to 18.7 percent. Taxpayers upset about declining productivity in government and increased waste have been wrong to focus solely on Washington over the past three decades.

Additionally, a June 1999 study by Ernst & Young points out that, because most e-commerce involves the sale of intangible services or other exempt products not subject to sales taxes, or is business-to-business, the actual "loss" to state and local sales tax collection was $170 million in 1998—one-tenth of 1 percent of sales taxes collected. Moreover, the definitive study on how taxing e-commerce would affect Internet sales was done by Professor Austen Goolsbee of the University of Chicago Business School, who found that changing the Constitution to allow taxation of electronic commerce would reduce e-commerce by 24 percent or more. (Now, that would do interesting things to the market capitalization of those companies presently driving up the Dow and the NASDAQ.)

Imposing new tax collection schemes on remote sellers would not "level the playing field" as the other team suggests. Rather, it would tilt the playing field heavily against online vendors and their customers. It would do this by imposing a massive, government-imposed barrier to market entry insofar as a single vendor selling goods on the Internet would be compelled to collect and remit sales taxes for more than 6,000 jurisdictions. A single "Brick and Mortar" retailer operating a single store only needs to collect taxes for one jurisdiction.

The Constitution's commerce clause is not a loophole. It created one coherent American market and stopped states from attacking "foreign" (out-of-state) businesses. The two pieces of legislation under consideration today go a long way toward preserving the commerce clause. We do not want to allow the federal government to tax the Internet out of existence—nor do we want to create a situation where Alabama politicians can levy taxes on New York businesses. We have already seen the damage Alabama juries do to "foreign" auto companies through the abuse of tort law.

As for "fairness:" Buy a book in your local bookstore in Washington, DC and you pay a 5.75% percent sales tax. Buy a book over the net and you pay $12.00 in overnight shipping fees. You have to buy more than $200 worth of books at a time for the dot com company to have any advantage.

One idea before the Electronic Commerce Commission that had merit was to urge states to lower or abolish sales taxes on big-ticket items, such as computers. This would eliminate any differential between electronic commerce and main street businesses without clogging up the Internet with tax collectors.

Governor James Gilmore of Virginia, who chaired the Commission on Electronic Commerce, has outlined a plan to ban taxes on electronic commerce altogether, to phase out the 3% federal excise tax on phone bills, to ban taxes on Internet access, to ban tariffs on international trade and to reduce the "digital divide" by allowing states to spend surplus welfare funds to buy computers and Internet access for families making the transition from welfare to work. Senator John McCain (R-AZ) and Congressman John Kasich have also introduced federal legislation to make the ban in Internet taxes permanent and to ban all sales taxes on electronic commerce.

In addition, the commission recommended banning the taxation of digitally transferred goods and services. To tax digitally transferred music, or computer software would require a tremendous violation of privacy of every American. Better to repeal those taxes than leave them on the books to be selectively enforced.

Congress might also wish to extend the protection of the 4R laws prohibiting discriminatory taxation on railroad lines to telecommunications. I believe this would greatly reduce the tax burden on lower income Americans using the internet.

Passing H.R. 1291 is an important step in preserving the economic growth of the Internet. In addition to this legislation, however, I urge Congress to enact the entire Gilmore Report: abolish the 3% Federal Excise Tax on telecommunications, sunset the Gore Tax, or E-Rate, extend the present moratorium on discriminatory taxes on the internet, and strengthen nexus standards to preserve Commerce Clause protections for all Americans.

Thank you for allowing me to testify today.

Mr. TAUZIN. Thank you, Mr. Norquist.

The Chair recognizes Mr. Harris Miller, president of Information Technology Association in Arlington, Virginia.

STATEMENT OF HARRIS N. MILLER

Mr. MILLER. Thank you very much. It is an honor to be here. I was disappointed to hear from Congressman Upton that Congressman Snell does not exist, because I went to a fund-raiser for his opponent last night.

It is an honor to be before the subcommittee to speak on an issue which is very important to the future growth of the Internet, and that is the issue of the access charges and trying to apply them to the Internet.

We at ITAA range across the whole range of companies with our more than 26,000 companies across the United States. We believe that both Mr. Upton's bill and Mr. Ehrlich's bill are very positive pieces of legislation. We look forward to working with this subcommittee, the full committee and the Congress to get these passed.

In the to and fro of the dry discussion of all these different charges, people tend to lose sight of what is really at stake. Mr. Cox brought this up in his questions before to Mr. Upton. If consumers had to pay the same per minute charges levied on long distance voice calls, access charges would lead to $20 to $35 a month per user. So if you are thinking of a household of two or three users, it is actually much more than what Mr. Cox was suggesting, possibly into the thousands of dollars.

Just simply traveling to Europe or to Japan and seeing how much difficulty they have had getting average consumers to use the Internet because of the telephone charges on a permanent basis drives home the point that Mr. Markey made earlier, that if you drive the costs up, even if you give away the Internet access itself for free, if you make the telephone charges that substantial, you simply are not going to have average consumers able to talk about accessing the Internet. We will not have a digital divide, we will have an unbridgeable digital Gulf. That is not what this Congress wants.

Second, it is important to continue to point out, as has been decided by this Congress and reaffirmed in courts in case after case, that Internet service providers are not, as a matter of law or a matter of policy, telecommunications carriers. They are customers of the carriers. They pay charges, too. They pay charges such as the subscriber line charges and other business line charges, and of course their customers do also.

It is also important to point out that the Universal Service Fund is not exclusively funded by the access charges. In fact, it is a combination of several different taxes that go together to serve as the Universal Service Fund.

I think as this subcommittee examines the possibility of what is going to happen to the Universal Service Fund as more Internet—telephone over the Internet grows, I think they have to look into the fact that it is not just access charges that are funding that but it is a whole series of charges.

In fact, FCC can try to work with Mr. Markey to drive down the access charges and perhaps look at some other charges, though I agree with Mr. Cox, we should not take this as a license for the FCC to go out and start regulating the Internet.

It is important to keep in mind that, as we look at all of these bills, that for many consumers, as you have seen in the e-mail traffic and messages you see from your consumers, access charges being applied to the Internet will become the third rail of Internet policy.

It is amazing to us that this issue does keep coming up. It has been killed off in the courts time after time. Like the vampire, it keeps resurfacing. Certainly I think Mr. Upton's bill, if passed by this Congress, would send a very clear message to the American people that this Congress will not support anything that is going to slow down the growth of the Internet and make it more difficult for all the American people to access the Internet.

I think it is again important to reiterate that access charges are not technically universal service contributions, even though that is how they are described. As a result, perhaps Mr. Upton's bill needs to be modified in another way also to make sure that it does not have that specific reference, as it currently does, because someone might imply from that that that is the only role for the access charges.

Again, Mr. Upton's bill as drafted may need some minor clarification in that area so it does not become read as directly contributing solely to the Universal Service Fund.

Any type of charges put on the Internet on a permanent basis will drive down usage. That is an area which we do not want to do.

We also have to make sure that—perhaps in Mr. Upton's bill another way to achieve the same purpose is simply by reaffirming that information service providers are customers of telecommunications carriers and that they should not be discriminated against relative to other end users. That may be another way of achieving the objective Mr. Upton's and Mr. Ehrlich's bills are trying to achieve.

Also, regarding the extension of the universal tax moratorium, Mr. Norquist says clearly and concisely, this issue is not just an issue of the Internet, though some people try to make it that way. It is a general issue of on what basis the types of charges can be levied on out-of-State businesses.

The Quill decision is out there. If Congress and elected officials want to change the Quill decision they should do it, but they should not try to ride the back of the Internet as a way of doing that. Obviously, that is a major public policy issue. It is unfair for people to come along and say the Internet is somehow different than these other charges.

I appreciate the committee's great efforts to continue to pursue policies that promote competition and keep the hands of the government off the Internet. In fact, yesterday we had our annual public policy summit and the chairman of the full committee, Chairman Bliley, came. The one phrase that he said that stuck in everybody's mind as he addressed our crowd was, his message to his colleagues is, hands off the Internet. That is the kind of message this entire committee and you, Mr. Chairman, as a subcommittee have been sending.

We encourage you to continue that, and we salute you for getting it right.

Thank you very much.

[The prepared statement of Harris N. Miller follows:]

PREPARED STATEMENT OF HARRIS N. MILLER, PRESIDENT, INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

INTRODUCTION

Chairman Tauzin and the other Honorable Members of this Subcommittee, I am Harris N. Miller, President of the Information Technology Association of America (ITAA). I am honored to testify today on HR. 1291 and HR 4202 which are intended to assure consumers that they will never have to pay so-called "access charges" to reach the Internet. ITAA members are very concerned with this issue, and I commend you for holding public hearings on these bills.

ITAA consists of 400 direct and 26,000 affiliate corporate members throughout the U.S. The Association plays the leading role in issues of IT industry concern including taxes and finance policy, intellectual property, telecommunications competition, workforce and education, encryption, critical infrastructure protection, online privacy and consumer protection, securities litigation reform, government IT procurement, and human resources policy. ITAA members range from the smallest IT startups to industry leaders in the Internet, software, IT services, ASP, digital content, systems integration, telecommunications, and enterprise solution fields.

It is my hope that the conclusions drawn from this hearing and the proposed bills in question will be the end of Internet access charge proposals, which I believe are the third rail of Internet policy. As you know, there has been a long history to this issue, with numerous attempts to impose them in the past. Fortunately today there is no serious or credible effort to impose access charges on Internet traffic. The members of this Committee, the Federal Communications Commission, the "industry leads" stance of this Administration, all have been helpful for leading us to this point, and deserve much credit.

And yet, the resurfacing of policies advocating special charges on Internet traffic is a little like the vampire in an old horror movie. You think you have killed it off, and yet some how, against all the odds, it has a way of resurfacing. I submit that access charges on Internet traffic would have the same life-sucking qualities as a vampire too—slowing adoption and take-up rates for Internet use, widening the so-called "digital divide" to a point where access would be out of reach for many Americans, and slowing the economic benefits the Internet has allowed Americans to enjoy. This hearing is an opportunity to drive a sharp stake through the heart once and for all. Thank you for taking on the task.

POLICY HISTORY

ITAA has been at the forefront of Internet policy even before there was an Internet. Over thirty years ago, in its First Computer Inquiry, the Federal Communications Commission (FCC) began wrestling with what it described as "the growing convergence of computers and communications has given rise to a number of regulatory and policy questions within the purview of the Communications Act."

ITAA has been a long time participant in policy deliberations in support of the robust development of the information services marketplace. Long before the explosion of ISPs, and the invention of the World Wide Web, the FCC took action that would eventually help pave the way for the nationwide growth of ISPs. In the end, these battles created the regulatory foundation on which the Internet now rests.

One of our continuing battles has been over whether enhanced service providers—or, as the Telecommunications Act of 1996 refers to them, Information Service Providers—should be required to pay access charges. ESPs provide a range of services that allow store, provide, and process information. These services range from simple voicemail, to on-line proprietary data bases, to today's Internet access services.

ESPs lease conventional telephone lines from local exchange carriers to receive "calls" from the subscribers. They interconnect these local facilities to packet-based private-line based networks (including the Internet) that carriers the traffic to remote servers. In some cases these servers are in the same state as the end user. In other cases, the servers are in different states. Indeed, in most cases, neither the user nor the ESP knows the locations in which the traffic terminates.

For nearly two decades, a debate has raged as to whether ESPs should pay the same state-tariffed local charges as other business users that lease identical local lines or whether ESPs be required to pay the same interstate "access charges" for the use of these facilities that long-distance carriers are required to pay. This is more than an academic debate. Business users with traffic patterns similar to ESPs pay a fairly low (but compensatory) flat-rate monthly charge for the use of the local lines. By contrast, long-distance carriers must pay per-minute charges that the long distance carriers pay to both the originating and terminating local telephone companies for each minute a long distance call is in progress. While the FCC has made

progress in restructuring and reducing these charges, they have always been—and remain—significantly above cost.

When the access charge system was established in 1983, "enhanced service providers" were classified as "end users" rather than "carriers" for purposes of the access charge rules, and therefore they are not required to pay the per-minute access charges that long-distance companies pay to local telephone companies.

While that conclusion is sometimes referred to as the "ESP exemption," in my opinion, that phrase misstates the reality of the FCC's conclusion. The Commission made a very a common-sense distinction. ESPs *use* telecommunications services to provide value-added services. They should not be treated in the same manner as telecommunications carriers.

The FCC's long-standing policy has been critical for the growth of the Information Services industry. Internet service providers, for example, can generally charge customers a flat monthly fee for access to the ISP via a local telephone call because the ISP purchases business telephone lines from a local telephone carrier. Customers then dial into a modem bank over lines provided by the local telephone carrier.

The FCC's policy is equitable. ESPs pay the same charges as similarly situated end-users—the subscriber line charge, the business line tariff and, where, applicable, a private-line interconnection charge. A portion of these payments are passed-on, by the local exchange carrier, to the Universal Service Fund.

This battle took other forms. For example, in 1987 a "modem tax" was discussed that would have required enhanced service providers to pay interstate access charges, which at that time were significantly higher than they are today. Thankfully, the proposal was abandoned in 1988.

More recently, in June 1996, four incumbent local telephone companies (Pacific Bell, Bell Atlantic, US West, and NYNEX) petitioned the FCC concerning the effects of Internet usage on these carriers' networks. They claimed that the growth of the Internet was a threat to the financial and technical integrity of their monopoly networks, and asked the FCC for authority to charge interstate access charges to ISPs.

Later that year, the commission asked for comments on the treatment of ISPs and other "enhanced service providers" that also use local telephone companies' facilities. In the *Access Reform Order,* FCC 97-158, adopted on May 7, 1997, the FCC rejected the claim that the growth of the Internet was harming the local monopolists, determined that ESPs use the local network in fundamentally different ways than do long-distance telephone companies, and determined that it would be inappropriate to extended the subsidy-laden carrier access charge regime to ESPs.

Unfortunately that order was challenged in court. ITAA again participated in this battle as an intervenor in support of the FCC. In August 1998, the Court of Appeals for the Eighth Circuit ruled in favor of the Federal Communication Commission and against Southwestern Bell Telephone Co.'s challenge on access charge reform.[1]

On the Internet access charge aspects of the case, the court concluded:

"As the FCC argues, the services provided by ISPs may involve both an intrastate and an interstate component and it may be impractical if not impossible to separate the two elements. See California v. FCC, 905 F.2d 1217, 1244 (9th Cir. 1990). Consequently, the FCC has determined that the [local telecommunications] facilities used by ISPs are "jurisdictionally mixed," carrying both interstate and intrastate traffic. FCC Brief at 79. Because the FCC cannot reliably separate the two components involved in completing a particular call, or even determine what percentage of overall ISP traffic is interstate or intrastate, see id., . . . the Commission has appropriately exercised its discretion to require an ISP to pay intrastate charges for its line and to pay the SLC . . ."[2]

That court's language, upholding the FCC's prior ruling, came very close to driving a stake once and for all through the possibility of Internet access charges.

In an unrelated 1998 proceeding, the FCC's 1998 appropriations legislation required a report to Congress on the legal status of Internet services under the Telecommunications Act of 1996. That report, the so-called "Stevens Report," again confirmed the existing access charge treatment for Internet traffic."[3]

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[1] *Southwestern Bell Telephone Co. v. FCC,* 153 F.3d 523, 543 (8th Cir. 1998)

[2] "SLC" refers to subscriber line charges.

[3] Federal Communications Commission, *Report to Congress On Universal Service Under the Telecommunications Act of 1996,* FCC CC Docket No. 96-45, April 10, 1998

THE FCC REPORT

In 1999 the Federal Communications Commission released a thoughtful report, *The FCC and the Unregulation of the Internet*.[4] It traces how a policy of government non-intervention in the data and information markets has significantly contributed to the development of the Internet. The Commission has tried to maintain essentially a hands-off approach to these markets in order to encourage competition, consumer choice and speed to market, fostering the development of an interconnected telecommunications network that ensured near universal availability of a reliable and affordable telephone system over which data services could be offered.

The FCC determined through the Computer Inquiry proceedings that computer applications offered over that network were not subject to regulation, giving rise to the unregulated growth of the Internet; and deregulating the telecommunications equipment market while requiring carriers to allow users to connect their own terminal equipment, helping to foster the widespread deployment of the modem and other data equipment tools that can be easily attached to the public switched network; and implementing flexible spectrum licensing policies that permit innovative uses of wireless data services, leading to the development of wireless Internet applications.

Most significant of all of the report's major conclusion was that not imposing on enhanced service providers the access charges paid by interexchange carriers was essential to helping drive the availability of reasonably prices, flat-rate dial-up Internet access.

STIFLING THE DIGITAL OPPORTUNITY

In the to and fro of the dry, even arcane regulatory battles surrounding access charges, we should not lose sight of the very real practical impact that these cumulative decisions have had on consumers. Seemingly miniscule access charges of 2 or 3 cents per minute would add $20 to $30 per month to the monthly costs of typical Internet consumers. Such charges would:

- Slow adoption of the Internet as a mass-market medium;
- Widen significantly the "digital divide";
- Hinder new, Internet-based businesses and information sources, which would become less attractive due to reduced take-up rates.

Over 6,000 Internet service providers (ISPs) today offer dial-up service to the Internet, and over 95% of Americans have access to at least four local ISPs.[5] Millions of Americans rely on small "one POP"[6] or medium-sized ISPs for their service, ISPs that may serve several hundred or fewer customers. There is no question that accessing an ISP through a non-metered telephone call allows consumers to attain affordable access to the Internet. Because of the favorable decisions of the FCC, ISPs can purchase the business lines they need to offer service from any local telephone company.[7] That so many thousands of ISPs offer service in this country at relatively low rates is evidence of the positive impact of the FCC's policy of treating ISPs as telecommunications end users.

Comparing the American consumer Internet market with the European, the advantages of treating ISPs as customers can be observed even more clearly. In the United Kingdom, for example, ISPs may offer a flat rate for monthly service, but end users are subject to per-minute charges for local dial-up connections to that ISP, resulting in a relatively expensive Internet experience for most consumers. Just as importantly, users are conscious of the fact that the meter is running. In the U.S., consumers whose ISPs are located within their local calling area generally pay a flat monthly fee to that ISP and are not charged per-minute rates for the local call to the ISP. This reflects the fact that, in an efficiently constructed network, the cost of carrying this traffic is not usage-sensitive. In fact UK policy makers are considering changing the way British consumers are charged for Internet access.

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[4] FCC Office of Plans and Policy Working Paper, *The FCC and the Unregulation of the Internet.* authored by Jason Oxman, July 19, 1999

[5] Downes, Thomas and Shane Greenstein, "Do Commercial ISPs Provide Universal Access," (Dec. 1998), available at http://skew2.kellogg.nwu.edu/greenste/research/papers/tprcbook.pdf.

[6] POP stands for Point of Presence and refers to the number of local nodes for dial-up access that the ISP has deployed.

[7] Although business telephone lines may feature metered usage rates (for intraLATA toll calls, for example), such per-minute charges are only assessed on outgoing, not incoming calls, and thus dial-up ISPs, which receive calls from customers dialing in to modem banks, would not be subject to such charges

PROHIBITING ACCESS CHARGES ONCE AND FOR ALL

Understandably, H.R. 1291 and H.R. 4202 seek to assure consumers that they will not pay access charges in the future. As I have already stated, I heartedly agree with this objective and commend you for trying to do this. However, on specific language of the legislation, I would offer a couple of qualifications:

Access charges are not as a technical matter, "universal service contributions." While they are often described in these terms, there is not a legal connection between the two. As a result, legislative language about "access charges to pay universal service" may miss its intended mark.

The greater question of Internet access charges is not simply a question of per minute charges; it involves any per-minute pricing structure that treats information service providers differently than other end users of telecommunications services. The modem tax discussion that I referred to earlier is an example.

The same intended result could be reached treating all information service providers as defined in Section 3 of the Communications Act—as end users, as customers of telecommunications services that should not be discriminated against relative to other end users. The best language to accomplish the objectives would:

- Give the FCC express authority to continue to regulate physically local telecommunications facilities and services used to carry traffic between subscribers and their information service providers (including Internet service providers);
- Continue the FCC's express authority to delegate price setting to the states; and
- Forbid discriminatory treatment between ISP-bound traffic and other physically local traffic delivered to a business end-user that interconnects a mixed-use private line network to the local public switched telephone network.

These are modest suggestions for the end product completely consistent with the legislation's intent. ITAA and our member companies are of course ready to work with you to discuss these approached on more detail.

CONCLUSION

If there should be a fundamental principle for Internet public policy, it is to draw upon the wisdom of the Hippocratic Oath—"first do no harm." There is a natural temptation with technology policy to tinker at the margins to reach desired ends. However, the Internet is evolving which such speed and dynamism that even the best-intentioned interventions can have unanticipated negative consequences.

This committee deserves great credit for pursuing these policies and resisting what may sometimes be the natural impulse of government to intervene. Instead, you have acted to encourage competition, and have pushed to see once closed markets opened up. And then stepped back to let markets respond. We salute you for getting it right.

Mr. TAUZIN. Thank you.

Mr. Leroy Grey of RAVEN-Villages Internet, Romney, West Virginia.

STATEMENT OF LEROY E. GREY

Mr. GREY. Thank you, Chairman Tauzin, Mr. Markey, and members of the subcommittee, for the opportunity to speak here.

I am appearing this morning on behalf of myself and the Commercial Internet eXchange Association, which advocates on behalf of ISPs in Washington. I would like to express our strong support for both bills.

As noted above, I am president of RAVEN-Villages Internet. Like the vast majority of service providers, my company operates under very strict conditions with little room for error. We have 600 customers. The large majority of them are dial-up residential and small business subscribers.

We are still growing at a fairly good rate, and we hope to continue to do so. But even in Romney, a town of 2,500 people, RAVEN-Villages Internet competes with three other ISPs. In 1999, RAVEN-Villages Internet had a gross profit margin of $22,000 on gross revenues of $130,400.

As a local ISP, we have designed our services and content to fit what we believe will be of interest to our friends, neighbors and customers. Because we are part of the community, we also try always to provide good connectivity, exceptional customer service and good value.

For example, in addition to the usual news groups and web hosting services, RAVEN contracts with MindLeaders.com, formerly DPEC, to provide local server access to over 365 computer, business and professional courses, including many Microsoft certificate courses.

To enhance communications between our customers and their friends and business associates worldwide, we recently enabled our website with FireTalk, which brings up the telephony issue. We agree totally with Mr. Cox with regard to the fact that you cannot separate the data—voice from the data; and, therefore, that is an important issue to try to prevent taxation or fees on the Internet access.

This free software, FireTalk, allows RAVEN's members to voice conference with up to 100 others as well as to take those conferees on web tours in which all participants' web browsers are synchronized to wherever the moderator browses.

RAVEN-Villages was one of the original 50 companies establishing the Freedom Network launched by ZKS at the spring, 1999, ISP conference in Baltimore. This revolutionary network was showcased on a 60 Minutes program and provides customers the ability to communicate on this network within a network in unparalleled secure private communications.

In our commitment to local service, value and community, RAVEN-Villages is like thousands of ISPs throughout the Nation. Unfortunately, we and they are also alike in our vulnerability to financial setbacks, competitive threats and technological markets changes.

In the Internet, there is constant technological transformation. As local providers, we must constantly upgrade our networks, software, trained personnel and leased telecommunications facilities. If our net revenues were affected by regulatory or legal developments, our capital expenditures would necessarily reflect these financial setbacks.

Though there are no precise statistics, it has been estimated that the average local United States ISP employs between 10 and 12 workers and has annual revenues in excess of $1 million. In short, the bulk of ISPs are small community-based businesses, and many of the new service providers specialize in serving residential and rural customers, consumers and small businesses which are not served by large national online Internet service providers, primarily because they are in the smaller regions.

Every year my company struggles to meet our modest profit margins so we can reinvest in our network and employees. Unfortunately, far too many service providers face similar or worse financial situations that could in time result in their exiting the Internet business.

In fact, one of our local competitors who at one time had nearly 9,000 customer went bankrupt in 1999. They have since reorganized and are still selling local access, but I benefited from their

poor service. I knew the president of this company well enough to learn that fierce competition eroded market share considerably, and that coupled with the loss of a major NASA contract led to their financial problems.

RAVEN has faced similar erosion of our new customer sign-ups when our local telephone company became our competitor in 1999. Our new sign-ups dropped from an average of 15 to 7 a week, and have remained at 50 percent of what they were before our local phone company became our competitor.

I do not have time to read much more of my statement, but, basically, as a local ISP, I am in favor of both bills.

I would like to summarize by saying that we believe that the codification of the current legal status of American ISPs is an appropriate and responsible position. We would urge the subcommittee to draft a strong report to accompany whichever bill is ordered reported.

In addition to the prohibition on access charges, we also support the 5-year extension of the Internet tax moratorium. We also have a minor suggestion with regard to definition of one of the terms used. We can supply that information later.

Thank you.

[The prepared statement of Leroy E. Grey follows:]

PREPARED STATEMENT OF LEROY E. GREY, PRESIDENT, RAVEN-VILLAGES INTERNET

Chairman Tauzin, Mr. Markey, Members of the Subcommittee, my name is Leroy E. Grey. I am the president of RAVEN-Villages Internet [http://www.raven-villages.net], an Internet service provider (ISP) headquartered in Romney, West Virginia. I appreciate your invitation to testify this morning on H.R. 1291, the Internet Access Charge Prohibition Act, introduced by Rep. Fred Upton of Michigan, and H.R. 4202, the Internet Services Promotion Act of 2000, introduced by Rep. Robert Ehrlich of Maryland. Both bills have similar prohibitions on access charges for universal service contributions. In addition, H.R. 4202 would extend the Internet tax moratorium an additional five years as recommended in the recent Advisory Committee on Electronic Commerce report.

I am appearing this morning for myself and the Commercial Internet eXchange Association (CIX), which advocates in behalf of ISPs in Washington. I would like to express our strong support for both bills, including Section 3 of H.R. 4202 that extends the tax moratorium. While I am not authorized to speak for the state ISP associations or the thousands of unaffiliated ISPs, unofficially at least, I have every reason to believe they would applaud the leadership of Rep. Upton and Rep. Ehrlich in introducing the two bills. Mr. Chairman, I would also like to thank you for your tireless efforts in behalf of online businesses and interest in the Internet.

If enacted, both H.R. 1291 and H.R. 4202 would provide a greater measure of financial certainty to ISPs and could stimulate network investment and innovation. This is not to denigrate the Federal Communications Commission, which has played an important historical role in promoting the public Internet and data services. However, Congress's role differs from that of the independent agencies and executive branch. You have the constitutional authority to make the laws of the land, not simply to administer, interpret or implement them.

This morning, I would like to do three things in my written statement and oral testimony. First, I shall describe the critical importance to a small business like mine of the current regulatory policy on "information services". Second, I would like to describe to you the ISP industry's historic leadership role in promoting and supporting Internet connectivity in the United States. Third, I shall review briefly why the status quo with respect to information service providers like ISPs should be extended into the future as proposed by the two bills.

I. IMPACT OF ACCESS CHARGES ON ISPS

As noted above, I am president of RAVEN-Villages Internet, an ISP in Romney, West Virginia. Like the vast majority of service providers, my company operates under very strict conditions with little room for error. We have 600 customers, the

large majority of them dial-up residential and small business subscribers. Even in Romney, a town of 2500 people, RAVEN-Villages Internet competes with three other ISPs. In 1999, RAVEN-Villages Internet had a gross profit margin of $22,200 on gross revenues of $130,400.

As a local ISP, we have designed our services and content to fit what we believe will be of interest to our friends, our neighbors, our customers. And because we are part of the community, we also try always to provide good connectivity, exceptional customer service, and good value. For example, in addition to the usual newsgroups and web hosting services, RAVEN contracted with MindLeaders.com (formerly DPEC) to provide local server access to over 365 computer, business, and professional courses, including many Microsoft certificate courses. To enhance communications between our customers and their friends and business associates worldwide, we recently enabled our website with FireTalk. This free software allows RAVEN members to voice-conference with up to 100 others as well as take those conferees on web tours in which all participants web browsers are synchronized to wherever the moderator browses. Lastly, RAVEN-Villages Internet was one of the original 50 companies establishing the "Freedom Network" launched by ZKS at the spring, 1999 ISPCon show in Baltimore. This revolutionary network was showcased on a "60 Minutes" program and provides customers who communicate via this "Network within a network" unparalleled secure, private communications.

In our commitment to local service, value, and community, RAVEN-Villages Internet is like thousands of ISPs throughout the nation. Unfortunately we—and they—are also alike in our vulnerability to financial setbacks, competitive threats, and technological and market changes. As you are well aware, the Internet undergoes constant technological transformation. As local service providers, we must constantly upgrade our networks, software, trained personnel, and leased telecommunications facilities. If our net revenues were affected by regulatory or legal developments, our capital expenditures would necessarily reflect these financial setbacks.

Though there are no precise statistics, it has been estimated that the average local US ISP employs between 10 and 12 workers and has annual revenues just in excess of $1 million. In short the bulk of ISPs are small, community-based businesses. Many of the new service providers specialize in serving residential and rural customers—consumers and small businesses—not served by the large national online and Internet service providers.

Every year my company struggles to meet our modest profit margins so that we can reinvest in our network and employees. Unfortunately, far too many service providers face similar or worse financial dilemmas that could, over time, result in their exiting the Internet access business. In fact, one of our local competitors, who at one time had nearly 9000 customers, went bankrupt in 1999. They have since reorganized and are still selling local access, but I benefited from their poor service, as many of their customers signed up with RAVEN. I knew the president of this company well enough to learn that fierce competition eroded market share considerably and that, coupled with the loss of a major NASA contract, led to their financial problems. RAVEN has faced a similar erosion of new customer signups when our local telco became a competitor in September 1999. Our new signups dropped from an average of 15 per week to 7 per week, and has remained, on average, 50% of what they were before our local phone company became a competitor. We already had two other competitors previous to our ILEC entering the market, but our figures did not drop until the ILEC's superior financial and marketing entered the picture.

Universal service charges are a form of taxation even though the revenues are dedicated to a worthy, socially desirable goal. We support universal service since it is self-evident that the more people on the network—even the PSTN voice network—the better for the Internet. However, taxes have the effect of reducing consumption of the product or service upon which the tax is levied. Access charges on information services like Internet access would adversely affect ISPs by repressing demand for connectivity. Access charges would either be passed on to subscribers in the form of higher charges (thereby discouraging greater use of the Internet) or absorbed by providers if market competition limited their ability to increase prices. Ironically, universal service charges would fall disproportionately on the very low income groups and individuals, who already suffer from inadequate access to information technologies.

The imposition of—or threat to impose—access charges would also have profound legal, regulatory, and economic implications. By failing to acknowledge the differences between information service providers and telecommunications carriers, a future Commission would essentially open the way for government regulation of Internet access and ISPs. Although the FCC has not demonstrated an inclination to alter its current policy that treats Internet access as an information service, a

statutory prohibition—as called for in the two bills under consideration—would ensure that a future Commission could not reverse that stand.

II. THE INTERNET SERVICE PROVIDER SECTOR

Commercial ISPs have been a dynamic part of the Internet economy from its very inception. As I noted above, there are 7000+ ISPs in the United States according to *Boardwatch* Magazine and CIX estimates. One academic study has estimated that almost every American has access to the Internet via at least one local service provider. More than **95** percent of all Americans have a choice of four or more ISPs, while tens of millions can choose from amongst dozens of vendors. I can assure you from my personal experience that our industry is highly competitive in price, service, and infrastructure facilities. Many small ISPs excel at customer service and consequently are fierce, tough competitors in their local markets.

The ISP industry traces its roots to the mid-1980's—well before most of the consumer friendly innovations in the early and mid-nineties that made the Internet such a technical, economic and social phenomenon. Service providers pursue different business models, different markets and different customer sets but are functionally alike in that they aggregate data and route them towards their final destination.

The explosive expansion in the early and mid-1990's of US Internet connectivity was due in large part to the tireless work and investments in data networks by US ISPs, which had long been active in providing access services. The flourishing US Internet economy stands in stark contrast to the situation prevailing in many other countries where the independent ISP sector is small and Internet access service is dominated by PTT monopolies. Subscribers in these countries face high per-minute telephone charges on top of their monthly Internet access bills. However, the absence of a strong independent ISP sector means weaker competition and a less innovative market in most regions outside North America.

Independent US service providers are also leading the way in providing hosting services and other value-added applications beyond Internet access. Providers in these developing new markets are called application service providers, or ASPs. Just as independent ISPs contributed greatly in the 1990's to establishing the US's Internet leadership, they could continue that role in the new millennium if the US Government stays its current course on regulation and market competition.

III. PROMOTING INFORMATION SERVICES AND INTERNET ACCESS

Current US Government policy on the regulatory treatment of information services generally and Internet access in particular is an amalgam of decisions dating to the early 1980's through 1996. Through trial and error, the United States has arrived at a set of core regulatory principles that have been successful in promoting innovation while protecting the public welfare. The US's Internet leadership is not coincidental but rather is the direct result US communications policies. The core principles are—

Fair competition among and between providers, networks and services wherever possible.
Minimal necessary regulation and cost burdens.
Support for innovation.
Private sector leadership wherever feasible
Consistent, market-based solutions.

During the past two years, CIX and several other state and national ISP trade associations filed comments in several FCC proceedings that dealt with the issue of the appropriate regulation of information services, particularly Internet access, and information service providers. The positions taken then were convincing and remain cogent.

ISPs already make substantial communications payments to local exchange companies to rent business lines from them, amounting to significant percentages of their annual revenues. They thus make indirect access charge payments to support universal service. The charge by some commentators that ISPs are being subsidized by ratepayers to the tune of several billion dollars is without foundation.

Communications payments are the largest single expense for ISPs amounting to between 30 to 50 percent of their revenues. The imposition of yet another charge would have a particularly adverse impact on small ISPs and those firms already in financial distress.

Furthermore, ISPs operate in a highly competitive, very low margin business which provides little room to pass along universal service charges or access charges to customers. The imposition of charges could even facilitate further consolidation among ISPs, with the greatest impact on smaller providers.

Even though ISPs indirectly pay into the universal service fund, it remains to be seen whether they will receive any benefits. Most state associations have reported that their members have not received any proceeds.

IV. CONCLUSION

Chairman Tauzin, we believe that the codification of the current legal status of American ISPs is an appropriate and responsible position. We would urge the Subcommittee to draft a strong report to accompany whichever bill is ordered reported. In addition to the prohibition on access charges, CIX also supports the five year extension of the Internet tax moratorium. I also have a minor suggestion with regard to the definition of one of the terms used. We shall work with the staff on technical issues and definitions. Chairman Tauzin, I deeply appreciate this opportunity to appear before you, and I would be pleased to answer any questions you may have.

Mr. TAUZIN. Thank you, sir.

The record will remain open for 30 days to insert statements.

The Chair recognizes himself briefly.

Let me first lay a predicate down, that we are in a period of transition from a regulated communications world to a marketplace-hopefully deregulated communications world, and that in this period of transition we have two Internet worlds. We have an Internet world that will be delivered on cable and some wireless systems and maybe even satellites that is subject to far less regulation than an Internet world delivered on telephones, and it raises certain questions.

When a cable company charges a customer a cable charge, a monthly cable rate and even a digital cable rate, if you want to go digital now, the cable company is free to do so today without government regulation, without local regulation. It simply charges its customers based upon its own decisions about its market, its value and the services to provides.

The customers, as I understand it, who sign up for digital cable services and who sign up for Internet services with the cable company will be dealing with primarily a free market contract condition.

On the other hand, those of us who use the Internet services over our telephones and hopefully 1 day digital broadband services fully over our telephones are dealing with an entity still regulated by government, still required to subsidize some customers at the expense of other customers, et cetera. The phone company, as Mr. Cox pointed out, charges us based upon these regulations, what it can and cannot charge, some set by a local PUC, some set by the Federal Communications Commission. They are really two worlds of the Internet.

I would like your comments on that, Mr. Miller and Mr. Norquist. How do we rationalize this period of transition and where should we be taking it as we move from one world to the next?

Mr. MILLER. I think you answered the question yourself, Mr. Chairman. Competition is the answer, competition in the telecommunications industry, which this committee had such an important role in starting the ball rolling down the hill in 1996, although we all think that the ball has not rolled nearly far enough down the hill.

Second, as you mentioned, cable is the second alternative. Wireless is becoming more available as an alternative. There are many major wireless companies now that are willing, although they don't always have access, to wire apartment buildings by putting wire-

less in, so that becomes another alternative. And then there are third-party lines over electric power lines. So the answer is competition. I don't think that Congress should get very focused too much on the short term.

Mr. TAUZIN. But the problem is in the interim some of the competitors are heavily regulated, and some are not. Some are restricted in where they can provide services and what services they can provide. In the real world of telephony, that might have worked. In the new world of Internet services, how should it work?

Mr. GREY. With regards to the local—well, in West Virginia the State Public Utilities Commission, we were supplying Internet access to the blind school, which is a State-run blind school located in Romney right across the street from us. We were doing that for free for about a year. That gave us residual income in other areas. We got some money from them for putting in a 16 LAN computer lab and various other things, but we gave that service for free.

The Public Utility Commission decided that they were going to make it statewide, that everybody in the State had to get connected, so they used the West Virginia University's Internet Provision Branch to provide that subsidy; I mean, through them to provide access to the Internet. Therefore we were cut out of the loop. And that happened to a lot of other Internet providers in the area, so I think that is something that needs to be addressed.

Mr. TAUZIN. Mr. Norquist.

Mr. NORQUIST. When we merged East and West Germany, we all wanted to go to the West German model, not come to some sort of compromise. We have heard this on, gee, the Governor of Michigan has high taxes on businesses in Michigan, and there are businesses in Maine that are escaping this; therefore, we should tax them. You either extend regulations to the unregulated market, that could even things up, or raise taxes on people that have presently not been taxed. That would even things up.

There are some political leaders whose idea of evening things up look like trying to even up the table by cutting the legs, and always toward higher taxes and higher regulations. I would hope that if somebody comes in and my taxes are higher than your taxes, fine, let's even the playing field down.

This is time when Federal and State governments are spending more than they need to spend, but they are raising more than they spend. It is exactly the right time to reduce taxes, and it is also the right time to speed up the process as much as possible of deregulating each of these industries.

I would recommend that you put telecommunications under the 4-R law which protects railroads from discriminatory taxes by State and local government, because when telecommunications—you have the same situation with power plants where government-mandated monopolies, lots of State and local governments tagged on lots of taxes. Politicians loved that because everybody got mad at the phone or power company rather than the mayor or the Governor. But now that we are deregulating both of these industries, you are deregulating both of these industries, we can't afford to have the high taxes on telecommunications and power plants. To the extent of putting the 4-R law that protects railroads from being looted by State and local governments, you can't have discrimina-

tory taxes. If you want to tax property in Utah 1 percent, fine, but you can't tax the railroad at 10 percent. We now tax telecommunications at 14 percent average, and sales tax and excise taxes on other industries are a third of that.

Mr. TAUZIN. According to the Freedom Foundation, there are some communities where telephone is taxed at 35 percent, and the mayor of one of those communities, now Chairman of our full committee, conceded that is exactly what mayors used to do. He is now sponsoring with me a truth in billing act to try to shed some light on those kinds of problems, so we have had a good confession from a former mayor who is trying to right that situation.

I am going to have to move to my friend quickly and go to a 15-minute floor vote followed by four 5-minute votes. We are going to have to take a good 30 to 45-minute break and return and finish unless we can finish now. The gentleman from Massachusetts.

Mr. MARKEY. Thank you, Mr. Chairman.

Mr. Pickering, a Republican from Mississippi on this committee, and I have introduced legislation on a proposal endorsed by the cellular phone industry for the Governors and municipalities to have a uniform method to collect cellular sales taxes on consumers' cell phone use. So we know it is possible for a high-tech industry to work with taxing jurisdictions to come up with workable solutions across State lines, which is where the domicile of the phone is, and that is the point of nexus, and the industry likes it, and Governors like it, and there is bipartisan support on the committee for the legislation.

How much time would States need to simplify their sales tax collection, Mr. Lowy?

Mr. LOWY. In the work we have been doing with the States, we think in the next 12 months they can come back to Congress with a framework that could be put in place. I think then if you look at the Minority proposal that came out from the commission, that they then believe that they would need another 2 years to put that framework into effect, so that 3 years from now I believe that they could be in a position to have a system that would work.

Mr. MARKEY. So is an extension of the tax moratorium necessary for the States to simplify sales tax collection?

Mr. LOWY. I think the way that we look at it with 16 months still to go on the current moratorium, that we should give the States enough time to try to put the framework in place in working with industry and themselves.

Mr. MARKEY. The current moratorium does not include anything about sales tax.

Mr. LOWY. It does not, but we look at it as an integrated approach to the total taxation on the Internet, and with the time period on the moratorium coming to a close, that is creating the political pressure and the pressure on both the industry and the States to get themselves together to get this framework and bring it back in front of the Congress.

Mr. NORQUIST. They first brought up State sales taxes in Mississippi in 1931. Governors and State legislators created the present structure that we have. There have been efforts dating back to the 1980's, and we heard testimony by the very people who now say that they are going to be able to do it, but they have never

done it before and haven't been able to do it, and the executive director of the NGA is telling people it is 5 years or more. So there is one line that they give you when they say don't do anything now, we will get it done in a year, and there is another line that the NGA staff is telling people 5 years plus.

Since they have been at it for 60, 70 years now, I tend to think that we are going to do it right away. First of all, they can do it now, and it has nothing to do with this legislation. Nothing stops the States from doing it now. All of the Governors who tell us they care deeply about this have been drifting in the opposite direction for 20 years.

Mr. MARKEY. I guess the comment I would make here is that the world has changed in 60 years. There is now a shotgun at their back, and many people do things with a shotgun at their back that they wouldn't do in the absence of that shotgun. What we are dealing with here is something that probably will get resolved at the gubernatorial level primarily out of necessity rather than some voluntary act that they would have engaged in.

Mr. LOWY. If you look at the extension of the moratorium today, if you look at an article that was put out in the Washington Post on February 24, in an interview with Governor Gilmore, he released a statement that the article characterized as a new proposal and is a political ploy that would get the tax moratorium extended, and by the year 2006 no tax collector would be welcome on the Internet. We actually think with the shotgun at the back of the States, and with the growth of the Internet, we can solve this problem within the time period allowed.

Mr. TAUZIN. Mr. Sawyer, if you can complete, we can wrap this up.

Mr. SAWYER. I would not ask the panel to stay for an hour so I could come back and ask questions. Let me just say I am particularly interested in Mr. Miller's comments and his testimony about the EU and particularly the U.K., and I was interested in whether there was any harmonization going on throughout the EU with regard to access fees; secondarily, that the fundamental difference in taxing architectures between the EU and the United States, one having much more to do with a wider range of taxation and the value added tax on which the Europeans depend so heavily and its effect on the topics that we are talking about here today.

Mr. MILLER. Really the problem in the EU is the whole method of charging individual subscribers. So you are paying every time the second rolls over even if it is a local call, as opposed to in the U.S. where it has been primarily long distance that you had different charges. So on top of that, they have discriminatory taxes. So you have a problem. Not only do you have to change the tax regime, but you have to get the monopolistic telephone companies to change their charging system. .

Mr. TAUZIN. We are going to have to wrap up.

Mr. SAWYER. Mr. Chairman, I get their answers in writing.

Mr. TAUZIN. Mr. Norquist?

Mr. NORQUIST. The European Union harmonization puts a floor in the value added tax of 15 percent. When the States get together in restraint of trade by setting floors under taxes, this is bad, not good.

Second, the National Governors Association is saying that they put out a statement signed by 36 Governors. I asked them for signatures. They could only deliver two signatures. I talked to the Governor, chief of staff of Pennsylvania, who said that they never signed it, although their name is on it. So I would suggest that is a taxpayer-subsidized lobby that illegally uses your Federal grants to lobby for higher taxes at the State level, and you might ask them to see those signatures.

Mr. TAUZIN. That is interesting.

Gentlemen, thank you. The Chair has to declare this hearing over. We have a vote on the floor. The hearing is declared over, and we thank you very much for your contributions.

[Whereupon, at 12:15 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

The American Federation of State, County and Municipal Employees (AFSCME) submits the following statement for the hearing record in opposition to Section 3 of the Internet Services Promotion Act of 2000 (H.R. 4202) to extend the moratorium on Internet taxes through calendar year 2006.

The originally-enacted Internet Tax Freedom Act (47 U.S.C. 151) imposed a three-year ban, ending September 30, 2001, on any new state and local taxes on Internet access and multiple or discriminatory taxes on electronic commerce. The practical effect of this law has been to exacerbate the existing de facto tax-exempt status of most such remote sales that result from the inability of states to collect sales taxes from purchases made by state residents from Internet and catalog sales. As a result, AFSCME respectfully urges that the moratorium be allowed to expire in September 2001 and not be extended through calendar year 2006 for the following reasons:

- The current moratorium does not expire for nearly 18 months. This provides time for the states to continue their work to simplify their sales tax systems, using a combination of technology-based software systems and administrative systems. The states are demonstrating that they can attack this challenge in a constructive and cooperative fashion. Congress should not arbitrarily constrain these efforts.
- State and local governments already may be losing on the order of $5 billion in sales tax revenues annually from their inability to tax most mail-order sales. With Internet sales growing rapidly, these governments could be losing an additional $10 billion annually by 2003 if Internet purchases remain effectively tax-exempt.[1] Revenue losses would continue to mount thereafter, as Internet sales grow over time.
- The loss of revenue will significantly impair the ability of states and localities to meet demands for education funding and other critical services. This scenario is particularly troubling in the context of education. There is agreement that primary and secondary education in the United States is in need of constant improvement so that our children receive the foundation that will allow them to fill the demand for high-skilled, well-educated workers in the information economy. Improving the education system requires investment. In fact, state education budgets consume 35 to 40 percent of state revenues. It is ironic that the Internet, the very tool fostering today's high-tech explosion, stands to play a pivotal role in the states' inability to fund the desperately needed improvements in the education system.
- Main Street retailers will be at risk of losing considerable business to remote sellers so long as they must add sales tax to their prices at the cash register while Internet and mail-order merchants can sell tax-free. There is evidence that this tax advantage is already distorting retail competition by compelling large retail chains to reorganize their operations solely to be able to compete with their tax-exempt Internet rivals.

For these reasons, AFSCME opposes the extension of the moratorium and supports enforcement and active collection of existing sales tax due on remote purchases.

[1] Center of Budget and Policy Priorities (February, 2000)

PREPARED STATEMENT OF THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

The International Council of Shopping Centers (ICSC) appreciates this opportunity to present its views to the U.S. House Commerce Subcommittee on Telecommunications, Trade and Consumer Protection on the need to apply existing state sales and use taxes to electronic commerce.

ICSC is the global trade association of the shopping center industry. Its 40,000 members in the United States, Canada and more than 70 other countries around the world include shopping center owners, developers, managers, investors, lenders, retailers and other professionals. The shopping center industry contributes significantly to the U.S. economy. In 1999, shopping centers in the U.S. generated over $1.2 trillion in retail sales and over $47 billion in state sales tax revenue, and employed over 11 million people.

Simply stated, ICSC believes that all goods, regardless if they are purchased over the Internet, via catalog or in traditional retail stores, should be subject to the same state and local tax collection requirements. One form of commerce should not receive preferential tax treatment over another. Unfortunately, existing tax law is structured to favor electronic commerce over sales made in local retail stores.

Contrary to popular belief, it is not the existing moratorium on Internet taxes that precludes states from requiring out-of-state retailers to collect sales and use taxes on their behalf. Instead, it is a 1992 Supreme Court case, *Quill v. North Dakota,* that held that remote merchants are not required to collect sales and use taxes for states in which they do not have substantial physical presence or "nexus". The moratorium—which expires in October, 2001—applies only to access charges and new, multiple and discriminatory state sales taxes. However, because many Internet retailers are not collecting existing sales and use taxes, a long-term extension of the moratorium will make this practice an accepted way of doing business.

ICSC does not support the enactment or implementation of Internet access charges, or new, multiple or discriminatory taxes on electronic commerce. Instead, we believe that existing sales and use taxes should be collected uniformly on all types of retail sales. The taxes which states should be able to require remote sellers to collect are not new taxes. Instead, they are existing use taxes which buyers are currently obligated to remit to their state and local governments. However, as a practical matter, most individuals are either unaware of their tax obligations, or simply do not bother to comply.

ICSC supports electronic commerce and believes it should be fostered. In fact, many traditional brick-and-mortar retailers are incorporating Internet commerce into their businesses in order to obtain new customers and better serve existing ones. However, as a matter of fairness and sound tax policy, Internet-based retailers should not receive a competitive advantage over traditional brick-and-mortar merchants simply because electronic commerce is a new and growing form of transacting business.

Although the extent to which Internet sales will displace traditional retail sales is unknown at this time, the competitive tax advantage that Internet-based retailers currently have could negatively affect many local retailers, shopping centers and their communities in the near future. Not only would traditional retailers generate reduced sales, but their employees would suffer from reduced working hours, wages or layoffs.

In addition, state and local governments would receive less sales tax revenues that go to provide essential public services (i.e., education, police and fire protection, road repairs). Governments that rely heavily on sales tax revenues would either have to cut back on such services or increase other taxes on local businesses and residents, such as property and income taxes. If governments decide to increase sales tax rates to make up for lost revenues, lower-income individuals would have to pay an even higher disproportionate share of their income on sales taxes since they are less likely to own computers and purchase products on-line.

It is this reason why many state and local governmental organizations support a level playing field for all types of retail sales. These government groups include the National Governors Association, Council of State Governments, National Conference of State Legislators, U.S. Conference of Mayors, National Association of Counties, National League of Cities and International City and County Management Association.

Our critics assert that electronic commerce is a new and growing industry and, therefore, should not be saddled with "old world" sales tax collection requirements. They say we should not kill the goose that lays the golden egg. Our response is that, while electronic commerce is a growing and important part of our economy, subjecting it to the same sales tax collection requirements that traditional merchants have been subject to for decades would not harm its growth or vitality. Electronic

commerce will continue to flourish, regardless of whether or not sales and use taxes are imposed on it.

These critics also claim that forcing Internet retailers to collect sales and use taxes for the thousands of state and local taxing jurisdictions across the country would be too burdensome on electronic commerce and just cannot be done. We agree that all businesses, especially small businesses, should not be overburdened by sales tax collection requirements and that state and local governments need to simplify their sales tax systems. However, inexpensive software exists today that can assist electronic retailers in determining how much sales and use taxes needs to be collected on their out-of-state sales.

Another argument made by our opponents is that states and localities are flush with cash and do not need to tax electronic commerce. While it is true that most state and local governments are currently enjoying budget surpluses, there is no guarantee that this economic prosperity will last indefinitely. (In fact, Kentucky and Tennessee are two states that are currently experiencing budget deficits. Their Governors strongly believe that the collection of this existing tax would be beneficial to their states' economies.) If and when our economy softens, many state and local governments, as well as traditional merchants, could suffer financial harm, especially if electronic commerce continues to displace traditional sales tax bases.

ICSC is disappointed that the Advisory Commission on Electronic Commerce failed to reach agreement that all retailers should be on a level playing field with regard to state and local sales taxes. Even more so, we are disappointed at the process of the Commission itself. To begin with, even though a traditional local retailer was supposed to be represented on the Commission, no such individual was appointed.

Second, the Commission sent a report to Congress that was agreed to by only 10 out of 19 Commissioners, clearly short of the 13 votes that was required under the *Internet Tax Freedom Act*. Third and most importantly, the majority report fails to address the level playing field issue.

Instead, it recommends (although not through an official "finding" or "recommendation") that Congress permanently extend the moratorium on Internet access charges, extend for five years the moratorium on multiple and discriminatory sales taxes, repeal the 3-percent telecommunications excise tax, establish special "nexus" carve-outs for Internet businesses, and create sales tax exemptions (such as those on "digitized" goods and their "non-digitized" counterparts) that would directly benefit the "business caucus" companies.

ICSC does not oppose the substance of the current moratorium (e.g. its ban against access charges and discriminatory taxes). However, we are deeply concerned that the longer the moratorium is extended, the more difficult it will be for Congress to level the playing field among retailers with regard to existing, non-discriminatory sales taxes.

The U.S. Supreme Court has recognized Congress' authority to enact legislation that would allow state and local governments to require out-of-state retailers to collect sales and use taxes. Therefore, we urge Congress to enact legislation that would level the playing field among Internet-based and traditional retailers.

Thank you for this opportunity to express our views on this very important matter.

The Heritage Foundation
Backgrounder

No. 1363 April 25 2000

AFTER THE NET TAX COMMISSION: THE GREGG–KOHL NEXUS SOLUTION

ADAM D. THIERER[1]

After a year of contentious hearings, extensive testimony, debate, and seemingly endless political grandstanding, the congressionally appointed Advisory Commission on Electronic Commerce submitted its final report to Congress on April 12, just before the deadline required by the Internet Tax Freedom Act of 1998.[2] Although the commission was unable to generate the two-thirds supermajority vote required by the act to send a "formal" recommendation to Congress on the subject of taxing electronic commerce, a simple majority of its 19 members did agree on a fairly comprehensive plan that addresses many Internet and telecommunications tax policy issues.

As the debate over Internet taxation shifts back to Capitol Hill, Congress would be wise to study the commission's final report closely, culling from its thoughtful analysis many important principles and recommendations. Specifically, lawmakers should look to establish firm rules for how the government levies taxes on this vibrant sector in the Information Age. One bill, the New Economy Tax Simplification Act (S. 2401), has been introduced to do just that. It would establish a set of ground rules for determining the types of activities that would be subject to state and local sales and use taxes.

Establishing such ground rules is vitally important because it would codify, extend, and clarify long-standing principles of fair and constitutional taxation that the Supreme Court has supported for many years. These "nexus" guidelines would preserve the taxing authority of state and local governments while simultaneously keeping the interstate electronic marketplace free of inefficient and potentially

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1. For a general overview of the Internet tax debate, see Adam D. Thierer, "The NGA's Misguided Plan to Tax the Internet and Create a New National Sales Tax," Heritage Foundation *Backgrounder* No. 1343, February 4, 2000.
2. Advisory Commission on Electronic Commerce, *Report to Congress*, April 2000, at *http://www.ecommercecommission.org/library.htm*.

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unconstitutional tax burdens. S. 2401, the nexus proposal introduced by Senators Judd Gregg (R–NH) and Herbert Kohl (D–WI), adheres to these principles. It would apply the Founding Fathers' governing tenet of "no taxation without representation" to the thorny issue of Internet taxation by clarifying that taxes should be levied only on those companies that have a substantial physical presence in a taxing jurisdiction.

THE COMMISSION'S REPORT

The bipartisan Advisory Commission on Electronic Commerce sought to examine all sides of the Internet taxation issue but in the end was able to achieve only a simple majority for most of the items upon which it voted. The commission's final public meeting, which took place in Dallas, Texas, in late March, demonstrated the difficulty: It became bogged down in parliamentary procedure and the obstructionist efforts of some members who hoped to discourage consensus. Most troubling were the actions of the three members appointed by the Clinton Administration who consistently abstained from voting on salient matters.

Under the Internet Tax Freedom Act (ITFA) of 1998, a formal recommendation on Internet taxation could be presented to Congress only if it was approved by a supermajority vote of 13 of the commission's 19 members. The most important and comprehensive proposal debated by the commission in Dallas, generally known as the business caucus proposal, received 11 votes. This proposal recommended:

- **Extending** the current ITFA moratorium on Internet taxes for five years;
- **Prohibiting** the taxation of digitized goods and products and their non-digitized counterparts;
- **Banning** all taxes on Internet access;
- **Abolishing** the 102-year-old federal excise tax of 3 percent that Congress imposed on telephone calls in 1898 to fund the Spanish–American War;
- **Encouraging** state and local governments to reform industry-specific telecommunications taxes;
- **Establishing** firm "nexus" rules for electronic commerce to make it clear when state and local governments could levy taxes on vendors of interstate commerce;
- **Encouraging** state and local officials to work together to simplify their sales tax collection systems and make them more uniform; and
- **Establishing** a new Advisory Commission to monitor these ongoing efforts and to determine whether states and localities should be allowed to collect taxes on out-of-state Internet vendors once tax code simplification is complete.

Many critics of the business caucus proposal, however, claimed that it represented "special interest politics" that would starve governments of sales tax revenue and hurt Main Street businesses.[3] Subsequently, many politicians and business groups that want Internet commerce to be taxed labeled the commission's effort a failure and vowed to fight to stop any of its recommendations from being implemented by Congress.[4]

Despite such acrimony, the commission's proceedings helped widen public awareness of the issue and provided an exceptional framework for debating complex tax issues. Moreover, the business caucus proposal represents a very balanced and generous compromise among the commission's members, since it provides a mechanism whereby state and local officials eventually could tax Internet sales if they simplified their tax systems to minimize compliance costs for vendors.

The opposition to the commission's report among many state and local tax officials typifies a "tax first, reform later" mentality that the majority of the commission's members rejected. As stressed by several members, the burden of proof rests on

3. David Cay Johnson, "Governors Criticize Internet Tax Panel," *The New York Times*, April 12, 2000, p. C6.
4. Paul Gigot, "GOP Governors Join the E-Tax Lobby," *The Wall Street Journal*, April 14, 2000, p. A18.

the shoulders of state and local governments to show that their tax systems and policies would not unduly burden interstate commerce; only then should they be allowed to expand their tax collection authority over interstate transactions. The pro-tax forces, by arguing against the commission's compromise, apparently want government at all levels to be free to impose any tax scheme on interstate commercial activity regardless of the impact it would have on consumers or companies.

Finally, with state and local surpluses and Main Street retail business revenues at an all-time high, it is difficult to accept the "sky is falling" logic of the proponents of Internet taxes.[5] For example:

- The National Trust for Historic Preservation's recently released 1999 National Main Street Trends Survey finds that sales for historic Main Street districts are booming and that the overall number of retail stores locating in historic downtown areas is growing. Moreover, it finds that the Internet is helping to drive this dramatic growth—increasingly, historic Main Street businesses are using the Internet to reach both new and existing customers.[6]
- Similarly, recent U.S. Department of Commerce aggregate retail sales figures have shown that retail activity has grown so much in recent months that the Federal Reserve is contemplating taking steps to ensure that the economy does not overheat.[7]

OPTIONS FOR CONGRESS

Although it is unlikely that the business caucus proposal will be adopted in its entirety by Congress,[8] elements of the plan have been introduced as legislation by various Members. The most common proposals currently on the table either would extend the Internet Tax Freedom Act's existing moratorium on "multiple and discriminatory taxes" on the Internet for another three to five years or would make that moratorium permanent.

Although this rather uncomplicated approach has broad bipartisan support in Congress, it unfortunately would do very little to help resolve the more complicated issue of how state and local consumption taxes will be levied on sales made over the Internet. The reason: A moratorium on "multiple and discriminatory taxes," whether temporary or permanent, would do nothing to prohibit state and local officials from moving forward with plans to tax electronic commerce. Congress could take the more radical step of banning all state and local sales and use taxes on Internet transactions to solve this matter, but that approach probably would meet with stiff political opposition and raise a number of constitutional concerns regarding outright federal preemption of state and local taxing authority.

The Gregg–Kohl nexus clarification proposal offers a practical, yet very principled, solution to this problem. S. 2401 would allow state and local governments to impose tax collection obligations on interstate vendors only when they have a "substantial physical presence" in their jurisdictions.

As the commission recommended in the business caucus proposal, S. 2401 also would create a series of sales tax "safe harbors" or "bright line tests" for interstate vendors to clarify when they were required to remit taxes. For example, under

5. See Thierer, "The NGA's Misguided Plan to Tax the Internet," pp. 16–19.
6. National Trust for Historic Preservation, "1999 National Main Street Trends Survey," March 26, 2000, at *http://www.nationaltrust.org*.
7. Yochi J. Dreazen, "Retail Sales Increased 0.4% in March, Raising Specter of Aggressive Fed Action," *The Wall Street Journal*, April 14, 2000, p. A2; Claire Mencke, "Hot Retail Seems to Cinch Rate Hike Even as Producer Prices Tame," *Investor's Business Daily*, April 14, 2000, p. A1.
8. Recent press reports have indicated that Representative Henry Hyde (R–IL), chairman of the House Judiciary Committee, may introduce legislation that would implement most of the recommendations in the commission's final report. See Alison Bennett, "Hyde in Final Stages of Developing Bill to Implement ACEC Majority Proposals," Bureau of National Affairs, *BNA Daily Report for Executives*, No. 73, April 14, 2000, p. G10.

the Gregg–Kohl proposal, the following activities would not, in and of themselves, establish tax nexus for interstate vendors of electronic commerce:

- The solicitation of orders or contracts for tangible or intangible property or services that are approved outside a state and are fulfilled from a point outside the state;
- The presence or use of intangible property in a state, such as patents, copyrights, trademarks, logos, securities contracts, money, deposits, electronic or digital signals, and Web pages;
- The use of the Internet to maintain a Web site accessible by customers in a state;
- The use of an Internet service provider (ISP), on-line service provider or other type of Internet access provider, or World Wide Web hosting services, to maintain, take, or process orders via a Web page site or server located in a state;
- The use of any service producer for transmission or communication by cable, satellite, radio, telecommunication, or similar systems;
- The affiliation with a person located in a state unless the person is an "agent" of the business entity who meets the substantial physical presence standard; and
- The use of independent contractors or representatives for warranty or repair services.

What makes the Gregg–Kohl nexus clarification effort so important is that it provides legal certainty for companies and consumers engaged in interstate commerce, regardless of what channel they use (such as the Internet, catalogs, mail order, and 800 numbers). By codifying firm principles of fair taxation, it essentially modernizes the Founding Fathers' tenet of "no taxation without representation" by making it clear that there will be no taxation without physical presence for vendors engaged in interstate commerce.

Some Members of Congress may be reluctant the engage in a debate over nexus matters because of the issue's legal complexity, or they may believe that the courts are better able to handle such matters. Such reluctance, however, would be a serious mistake. Federal legislators cannot continue to rely on the courts to do their job for them. Although legislative debate over nexus will be challenging, Congress accomplished a similar task after debating income tax nexus policy. Moreover, continuing to rely on court-based interpretations of nexus is tantamount to a dereliction of duty and invites endless and costly litigation to resolve what is, at its core, a congressional responsibility—the regulation of interstate commerce.

For policymakers who fear that a debate over nexus will invite a heated showdown with state and local governments, it is important to stress that the codification of nexus principles by Congress would not prohibit *all* forms of Internet taxation by states and localities. S. 2401, for example, would provide state and local officials with clear guidelines on what is constitutional in taxing interstate goods, services, and technologies. Once these nexus rules of the road for electronic commerce were in place, states could choose to tax sales made over the Internet, but they also would be restricted to levying taxes only on activities that met the bright-line nexus standards established under S. 2401's guidelines.

These nexus rules would, in turn, encourage the states to adopt a clear and constitutional "sourcing" rule for the taxation of electronic commerce. In other words, by making it clear that extraterritorial taxation would be prohibited in virtually all cases, S. 2401 would encourage state and local governments to adopt an "origin-based" tax methodology under which they would levy sales taxes only on companies whose principal place of business resided within their taxing jurisdiction. Sourcing all sales to the location of origin instead of the destination of sale would enable state and local governments to impose taxes on Internet (and catalog) sales in the same way they impose them on traditional Main Street retail sales.

Unreliable and increasingly unenforceable use taxes could be completely extinguished under this system, since governments would tax only transactions that originated in their states.[9] Such an origin-based system of electronic commerce would level the playing field with traditional retail merchants and also fit squarely within the confines

of the Constitution and nexus rules, since it would meet the requirement that the business must have a "substantial presence" within a jurisdiction before it can be taxed. Moreover, it would encourage vigorous state-by-state tax competition, since governments would need to be wary of the burdens their tax systems imposed on their companies and citizens.[10]

Other states might reject product-based sales taxation altogether and instead opt to tax consumption through an income tax. In other words, instead of trying to continue the increasingly difficult process of tracing the movement of goods in order to tax individual consumption, states could adopt a savings-exempt income tax that excludes all savings from taxation and taxes the consumption portion of individual or corporate incomes. This would allow state and local government to continue to impose consumption taxes while at the same time scrapping their increasingly unworkable and inefficient sales and use tax systems.[11]

Keeping in mind the commission's conflict-ridden proceedings and findings, as well as a legislative calendar abbreviated by this year's presidential elections, the most prudent course of action for Congress would be to:

- **Make permanent** or extend the existing ITFA moratorium on multiple and discriminatory taxes;
- **Codify firm nexus ground rules** that clarify how states and localities may impose taxes on electronic commerce; and
- **Abolish the 3 percent federal excise tax,** a century-old "tax on talking" whose repeal has achieved broad bipartisan support.

This is a reasonable agenda for Congress this year and, if necessary, next year. Once the foundation has been established, state and local officials can decide for themselves what types of tax reforms, if any, they need to undertake within their jurisdictions.

CONCLUSION

A simple extension of the Internet Tax Freedom Act's current moratorium on Internet taxes will not be sufficient to resolve the Internet tax impasse policymakers face today. Firm rules of the road, in the form of codified nexus rules for the economy in the evolving Information Age, offer the most optimal resolution of this issue.

A nexus proposal of the sort found in the Gregg–Kohl legislation would apply clear principles of fair taxation to the world of electronic commerce. S. 2401 would not prohibit all forms of Internet taxation, but it does demonstrate the principle that there should be "no taxation without representation." Just as this principle guided America's founding, so too should it govern policymaking for today's high-tech economy.

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9. Use tax enforcement traditionally has been riddled with problems, and increased use tax oversight is likely to breed discontent among the increasingly privacy-conscious American public. As Dana Mayton, a member of Kentucky's state revenue department, has noted, "People really feel that use-tax compliance is Big Brother at its finest." Richard Wolf, "Status of Use Tax Likely to Rise," *USA Today*, April 11, 2000, p. A4.
10. See "Debate: NGA's Shafroth, Heritage's Thierer on Streamlined Proposal, Origin-Basing for E-Commerce," *State Tax Notes*, Vol. 18, No. 4 (January 24, 2000), pp. 279–290; Terry Ryan and Eric Miethke, "The Seller-State Option: Solving the Electronic Commerce Dilemma," *State Tax Notes*, October 5, 1998, pp. 881–892; Andrew Wagner and Wade Anderson, "Origin-Based Taxation of Internet Commerce," *State Tax Notes*, July 19, 1999, pp. 187–192.
11. See Murray Weidenbaum, "Taxing E-Sales Without Hindering the 'Net,'" *Christian Science Monitor*, January 20, 2000, at *http://www.csmonitor.com/durable/2000/01/20/p9s2.htm*; Hal R. Varian, "Taxation of Electronic Commerce," Internet Policy Institute, April 2000, at *http://www.internetpolicy.org/briefing/4_00_story.html*.