S. HRG. 107–1134

EXTENSION OF THE INTERNET TAX MORATORIUM

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

MARCH 14, 2001

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

90–544 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JOHN MCCAIN, Arizona, *Chairman*

TED STEVENS, Alaska	ERNEST F. HOLLINGS, South Carolina
CONRAD BURNS, Montana	DANIEL K. INOUYE, Hawaii
TRENT LOTT, Mississippi	JOHN D. ROCKEFELLER IV, West Virginia
KAY BAILEY HUTCHISON, Texas	JOHN F. KERRY, Massachusetts
OLYMPIA J. SNOWE, Maine	JOHN B. BREAUX, Louisiana
SAM BROWNBACK, Kansas	BYRON L. DORGAN, North Dakota
GORDON SMITH, Oregon	RON WYDEN, Oregon
PETER G. FITZGERALD, Illinois	MAX CLELAND, Georgia
JOHN ENSIGN, Nevada	BARBARA BOXER, California
GEORGE ALLEN, Virginia	JOHN EDWARDS, North Carolina
	JEAN CARNAHAN, Missouri

MARK BUSE, *Republican Staff Director*
ANN CHOINIERE, *Republican General Counsel*
KEVIN D. KAYES, *Democratic Staff Director*
MOSES BOYD, *Democratic Chief Counsel*

CONTENTS

WITNESSES

APPENDIX

EXTENSION OF THE INTERNET TAX MORATORIUM

WEDNESDAY, MARCH 14, 2001

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. First let me thank the witnesses for being here today. This hearing is similar to one held by the Committee nearly a year ago to examine whether to extend the Internet Tax Freedom Act's moratorium on the ability of state or local governments to impose new sales taxes on Internet access services, or to impose any multiple or discriminatory taxes on electronic commerce.

Opponents of the extension of this limited tax moratorium succeeded in postponing its consideration last year. We face different circumstances now. Foremost, the Internet Tax Freedom Act expires this October. I believe the Congress will and must act before then to renew its objections to multiple and discriminatory taxes on the Internet as well as to taxes that inhibit Internet access.

One needs only to turn on the news or glance at the front page of the paper to know that the Internet economy is not bullet-proof. The plunge in the NASDAQ is a clear sign that we need to be mindful of the economic effects of our tax policy decisions as we move forward on this issue, and we must move forward. Several states and localities, as well as the majority of the so-called brick-and-mortar retailers, have asked that we consider legislation in addition to just the extension of the Internet tax moratorium. Principally, they have asked Congress to authorize them to require all remote sellers to collect and remit sales taxes on deliveries into their states, provided that the states and localities dramatically simplify their sales and use tax systems.

I have met frequently with Members of Congress, including several on this Committee, who are interested in joining me to extend the Internet tax moratorium, but only as long as we take action to broaden the state's authority to collect sales taxes from remote sellers, including those conducting business on the Internet. We pledge to work together on a consensus proposal that we can put in place before the moratorium expires in October.

Personally, I have not seen evidence of the sales tax revenue losses predicted by the states and local governments when we took up this issue a few years ago. Even so, the Main Street retailers have a legitimate fairness argument when they see customers come to the store to locate items they want to purchase, only to leave and order the items over the Internet just to escape the sales tax.

I want to emphasize again, Congress must act before the Internet tax moratorium expires in October. Reaching its consensus by then on the broader issues that we will hear more about today will be difficult. All interested parties must be willing to make significant sacrifices. The states and localities in particular must be able to make some tough decisions now to advance true sales tax simplification before Congress will consider subjecting remote sellers to the reach of more than 7,000 taxing jurisdictions in the United States. I do not think that is too much to ask.

The states and localities are asking us to overturn longstanding limits on their ability to tax out-of-state businesses and transactions put in place to ensure that myriad taxes do not create an undue burden on interstate commerce.

Thanks again to our witnesses, and I look forward to hearing testimony today from Governor Geringer and Lieutenant Governor Swift. Opening statements. Senator Kerry.

[The prepared statement of Senator McCain follows:]

PREPARED STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

First, let me thank the witnesses for being here today. This hearing is similar to one held by the Committee nearly a year ago to examine whether to extend the Internet Tax Freedom Act's moratorium on the ability of state or local governments to impose new sales taxes on "Internet access services," or to impose any "multiple or discriminatory taxes" on electronic commerce.

Opponents of the extension of this limited tax moratorium succeeded in postponing its consideration last year. We face different circumstances now. Foremost, the Internet Tax Freedom Act expires this October. I believe that Congress will and must act before then to renew its objections to multiple and discriminatory taxes on the Internet, as well as to taxes that inhibit Internet access.

One needs only to turn on the news or glance at the front page of the paper to know that the Internet economy is not bulletproof. The plunge in the NASDAQ is a clear sign that we need to be mindful of the economic effects of our tax policy decisions as we move forward on this issue, and that we must move forward.

Several states and localities, as well as the majority of the so-called brick and mortar retailers, have asked that we consider legislation in addition to just the extension of the Internet tax moratorium. Principally, they have asked Congress to authorize them to require all remote sellers to collect and remit sales taxes on deliveries into their states, provided that the states and localities dramatically simplify their sales and use tax systems.

I have met frequently with members of Congress, including several on this Committee, who are interested in joining me to extend the Internet tax moratorium, but only as long as we take action to broaden the states' authority to collect sales taxes from remote sellers, including those conducting business on the Internet. We have pledged to work together on a consensus proposal that we can put in place before the moratorium expires in October.

Personally, I have not seen evidence of the sales tax revenue losses predicted by the states and local governments when we took up this issue a few years ago. Even so, the Main Street retailers have a legitimate fairness argument, when they see customers come to the store to locate items they want to purchase, only to leave and order the items over the Internet just to escape the sales tax.

I want to emphasize again. Congress must act before the Internet tax moratorium expires in October. Reaching a consensus by then on the broader issues that we will hear more about today will be difficult. All interested parties must be willing to make significant sacrifices.

The states and localities in particular must be able to make some tough decisions now to advance true sales tax simplification before Congress will consider subjecting remote sellers to the reach of more than 7,000 taxing jurisdictions in the United States. I do not think that is too much to ask. The states and localities are asking us to overturn longstanding limits on their ability to tax out-of-state businesses and transactions, put in place to ensure that myriad taxes do not create an undue burden on interstate commerce.

Thanks again to our witnesses. I look forward to hearing your testimony today. Governor Geringer, welcome to the Committee. Would you like to begin?

STATEMENT OF HON. JOHN F. KERRY, U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you very much. I will be very brief. Let me take this opportunity to welcome our Lieutenant Governor here, all three of you. We are delighted to have you here and look forward to your testimony. She has been involved in our state on the electronic signature and the Internet tax issue, and we certainly welcome her opinion today, and Governor, also, thank you for being here with us.

Mr. Chairman, we have had a number of meetings, one most recently, I guess about 3 weeks ago, a month ago, where a number of us on this Committee sat down and tried to come to grips with this issue. We have been working on it for some period of time now. It is good that we are here to followup with another hearing, but my hope is, and I have expressed this to you personally, that we are going to be able to move very soon to a markup on this.

I think most people understand that we want to continue to have a moratorium on any kind of discriminatory taxation whatsoever. I think that is good for the Internet, that is good policy, and we want to try to continue that. But there is also, I think, a growing consensus now among many Internet, most Internet providers, service providers, and certainly business people, that we have got to have a playing field that makes sense. You cannot have sort of a Cayman Island situation in cyberspace to the disadvantage of bricks and mortar, and you cannot create a loophole where people can just sort of set up some kind of quick-buy Internet capacity right outside the store they visit to pick all the items they want and avoid taxation as a result.

Communities all across this country depend on that. Certainly we can come up with a structure that encourages all of the states to figure out for themselves what the best method is for each state, but we cannot have thousands of jurisdictions competing. We cannot have people absolutely incapable of figuring out what tax they owe and how, and to which jurisdiction. It seems to me that everybody has an obligation to come up with a sensible way of mixing the national interest here and the local interest, and prerogatives of determining locally how they would like to treat their own uniformity within a state.

So my hope is that this hearing will really sort of set us on the road to a relatively imminent markup so we could proceed forward. This is an important piece of legislation, and we need to clarify for many users how this playing field is going to be equalized and fair.

Thank you.

The CHAIRMAN. Thank you, Senator Kerry. It is interesting that the three most active Senators on this issue are here with us this morning. Senator Dorgan.

STATEMENT OF HON. BYRON L. DORGAN,
U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Chairman, thank you very much. This is clearly a complicated issue, but yet a very important issue, and I would agree with the chairman and with Senator Kerry that we should and we will extend the moratorium. No one supports punitive taxes, discriminatory taxes on Internet transactions, so we will extend the moratorium.

My hope, however, is that while we do that we will also take the time and make the effort to fix some of the other problems that exist with remote sales. It is important for everyone to understand that a tax already exists on almost all of these transactions, with the exception of the few states that do not have a sales tax. In other circumstances the tax always exists. If it is not collected by the seller, it then exists in the form of a use tax which is then never paid to the state governments, and that is the issue.

The question is, could we find a way to require state and local governments to substantially simplify the collection requirements for remote sellers? I believe we should. We ought not ask a remote seller to comply with thousands and thousands of different jurisdictions with different rates and different bases, but if we are able to do that, to provide substantial simplification, then can we and should we not ask remote sellers to collect the tax. The answer to that ought to be yes, but we ought to do it in a thoughtful manner. The discussions many of us have had I think would allow us to reach agreement on that. There are different opinions here, but we ought to, in my judgment, be able to come together to fix it.

The Commerce Clause requires that the Congress make this judgment. I know some feel the states can do it by themselves. I do not share that judgment. I do not believe the federal courts are going to allow the states to solve this problem. I think Congress must address it, and we must do it in the right way.

Mr. Chairman, one final point. We had testimony at that table by one of our country's largest merchandisers, who described the need to set up a separate corporation to be able to make a remote sale of that which someone wants to purchase from their store so that they can sell it without the collection requirement of a tax.

That clearly, in my judgment, in the future will dissipate the amount of revenues that are used, and it is probably just coincidence, but roughly $160 billion is collected by the sales and use taxes by the states, and roughly $160 billion is spent on and elementary and secondary education. It is probably a coincidence, but it is very important to understand the consequences of this issue and our need to respond to the growth of remote sales and the lack of collection of the central tax that underscores the funding requirement for elementary and secondary education.

Having said all that, I thank you for holding the hearing. This is a tough issue, and you have been neck-deep in this issue because you care about solving it, and I think that is something that we are all grateful for, Mr. Chairman.

Thank you very much.

The CHAIRMAN. Thank you, Senator Dorgan. Senator Wyden.

STATEMENT OF HON. RON WYDEN,
U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, and I share, Mr. Chairman, your views and those of our colleagues. I think it is clear we are going to work very hard and cooperatively to come up with a solution here. Having been the original sponsor of the Internet Tax Freedom Act I would just offer the judgment that I do not see what the significant problems are with the bill as written. It is a straightforward ban on discriminatory taxes on e-commerce, and that just means if you buy your local newspaper and there is no tax on the local newspaper when you buy it the traditional way, you do not pay a tax if you read it online.

A local jurisdiction can impose a variety of taxes on Internet commerce as long as it does to the offline world what it does to the online world, so we ought to be clear, there is no Cayman Islands today with respect to Internet sales. You can tax the Internet, you have got to just treat the offline world like you do the online world.

Two other points are significant. First, there has not been a jurisdiction in this country that has been able to show that they have been hurt by their inability to impose discriminatory taxes on electronic commerce, so this bill, which bars discriminatory taxes on electronic commerce and which has generated considerable discussion on the part of local officials, in my view requires that somebody, if they want to turn this thing on its head, come forward and show that they have actually been hurt by their inability to impose a discriminatory tax on electronic commerce. I have been unable to find a jurisdiction in this country that has been hurt by their inability to impose discriminatory taxes.

The last point I would mention involves a Supreme Court case, which is really what is at issue with respect to these remote sellers. The question is, should you tax one of these remote sellers, who has got no presence in a local jurisdiction other than a website? The U.S. Supreme Court has said, and this is really what is at issue in our efforts to work all this out and produce a bipartisan and cooperative bill, the Supreme Court has said, you do not tax somebody unless they have got physical presence somewhere, and for fairly obvious reasons, they are using roads, and water, and sewers, and the like.

That is not what is going on with these remote sellers, and I would only say, because I am anxious to work with our friends here, and we have had very good discussions, that at a time when the technology sector is very fragile, and we see that in the newspaper every day, I would just hope that we are very careful in terms of how we proceed here.

There has not been evidence that somebody has hurt. You have got the technology sector fragile—and we are talking about throwing a Supreme Court decision out the window, and taxing folks who have no physical presence somewhere, and that is the case.

If you have got physical presence somewhere, kiosks, and the like, then it is a different story, but what concerns me is people who have no physical presence somewhere, and I, as you have said

and our colleagues have said, believe that we are going to work very constructively to get at this, and time, of course, is of the essence, and I thank you.

The CHAIRMAN. Thank you, Senator Wyden.

Senator Stevens.

STATEMENT OF HON. TED STEVENS,
U.S. SENATOR FROM ALASKA

Senator STEVENS. I have no comments this morning.

The CHAIRMAN. Thank you, sir.

We would like to welcome Hon. Jim Geringer, the Governor of the State of Wyoming, and Hon. Jane Swift, the Lieutenant Governor of the Commonwealth of Massachusetts. Governor Geringer, we would like to begin with you. Thank you for taking the time to appear before our Committee, and we appreciate your involvement in this very important issue.

STATEMENT OF HON. JIM GERINGER, GOVERNOR,
STATE OF WYOMING

Governor GERINGER. Thank you, Chairman McCain, and thank you to the Members of the Committee who are here today to participate in this hearing. I am Jim Geringer. I am here as Governor of Wyoming, but I am also here to speak on behalf of the National Governors' Association, who just recently overwhelmingly reaffirmed their approach to working for a simplified tax system for our states to adopt, and working through the states. We are here to ask for your partnership to help enable that.

Last night, as I was flipping through the channels, one of the meeting notices that came up on the hotel marquee where I was staying provided a notice there is a meeting coming up today to ban land mines, and I thought of that as I thought of this meeting this morning. Land mines, those unexpected things that pop up here and there.

Today's discussion ought to be defined in terms of what it is or is not, and I would like to start with that. Today's discussion is not about taxing the Internet. Obviously, there have been statements already made about extending the moratorium, which the NGA, the National Governors' Association supports. Today's discussion is not about new taxes on the Internet.

Today's discussion is about whether our states and cities, our local governments, will be able to collect currently authorized taxes, and several of you this morning have already made reference to the shift in how e-tailing, or retailing, or e-commerce, or business-to-business transactions are shifting toward an Internet-based transaction, and the uncertainty that was created by the previous Internet Tax Freedom Act, definitions that are there that are unclear as to whether something is or is not a remote sale or an Internet-only sale.

This is also not about whose state is most friendly toward high technology, or the new economy businesses. In fact, if I were to gauge which state is most friendly in terms of the cost of doing business, I would say Wyoming. Come on down. We can treat you well. We do not have tax rebates because we do not tax it to begin with. We leave the money in your pocket.

But we do need to talk about the nature of business transactions in the new economy, and much of our discussion this morning will be for us to understand just the nature of how business transactions are occurring, and financial transactions are occurring over the Internet, and what it does to our states. Again, we are here to ask for your partnership to simplify the sales and use tax collections. Let me emphasize that point again. It is collections. It is not to impose taxes. It is whether or not we will be enabled.

So I come back, Mr. Chairman, to your invitation to appear today, as to whether Congress should allow states to require all remote sellers to collect and remit sales taxes. I would say, Mr. Chairman, that the issue is not whether Congress should allow, but whether Congress should enable the collection of such taxes, and the answer is yes.

Electronic commerce is not new. Electronic commerce has been around for sometime. I look back to my own experience with technology. I worked in the Air Force Space Program, worked with NASA. I can still recall when fax machines came along, and we had this marvelous new thing that could transmit one page in 7 minutes, just a remarkable invention at the time, but that must have been the same feeling as when Marconi invented the telegraph, or Alexander Graham Bell invented the telephone. They initiated electronic commerce, so it is not new.

The new economy is not new, either. It is just more noticeable, and what is most noticeable about the new economy is productivity, and that is what we are talking about today. How can we foster the continuing and sustainability of the new economy through productivity increases? That is what the new economy has fostered. That is what technology has enabled.

Our citizens are accustomed to access to the Internet, and they will continue to demand access through the Internet for everything in their lives. What we want to talk about today is what businesses want. Businesses want from the states predictability, particularly in taxes. They want uniformity, and our choices today would be that we impose no tax at all for anything that is done for a business transaction, or we could propose that the Congress mandate a tax, or a tax approach, or we could say to the states, if you could come up with a way to develop a uniform system to taxation and its collection, then we can work to eliminate the existing patchwork of state and local laws, and enable the growth in the new economy that we all desire.

The Internet Tax and Freedom Act, Senator Wyden, that you sponsored, has a statement associated with it that information should not be taxed, and we agree. Commerce conducted over the Internet should not be taxed in new and creative ways. We agree.

The question is, what happens to state revenue sources that currently depend on sales taxes as they shift? What we are talking about, Mr. Chairman, is, today's taxes are authorized at this level. Transactions on the Internet are fairly low, and what we are seeing is a trend that is causing the balance to shift, and what we are looking for is the ability of the states to collect the same taxes that would already be due them, but they cannot reach them because their jurisdiction does not apply.

The reason it is important is because of the 45 states who levy sales and use taxes in some form—and use tax is due, as Senator Dorgan said. Even though it may not be collected, it is still due. How do we collect it? Forty-five states impose some sort of a sales and use tax, and nationwide about 40 percent of all state revenues do depend on sales and use taxes, and where does that money go?

In Wyoming over 50 percent of it goes to education, so as we talk about the impact on the states, and it is real, we do have forecasts of the growth that will happen, the real issue is, how much will be shifted away from education? How much will be shifted away from health care, prescription drugs, or other things that the states are currently engaged in helping to fund, and how much will have to shift to other tax areas or shift away from providing these vital services?

The issues today include energy, and I will talk a little bit more about that later, because Wyoming is quite an energy-producing state, and I will talk about the impact that may come about.

The reason sales tax is important to the state, probably more so than the Federal Government, is that the Federal Government generates its revenues almost entirely from income tax. Income tax is only one leg of a three-legged stool for the states.

Our message today should be fairly simple. By the rule of unintended consequences, Congress should not preempt the state prerogatives on tax issues. You should enable, and can enable the states to come up with their own approach that will lead to uniformity, and how current authorized taxes may be collected in the future.

Our states have already begun to cooperate and simplify local tax systems, and state tax systems. We have a number of states who are participating, and Mr. Chairman, I would make reference to the last page of the testimony that has been provided. There is a map that shows the United States, the 50 states and their participation in the simplified tax approach that we are taking through our own initiative.

If you look at the chart, it shows a variety of colors, and let me point out that the blue, the red, and the green states are all involved in our simplified tax project. The light blue in Wyoming indicates that Wyoming was the first state to adopt model legislation to enable the compact that would allow our states to work together. The darker blue, legislation has been introduced and is pending approval. Several states are anticipating signature within the week. The states that are red, they are official participants, but have not yet introduced legislation to develop the project. We believe we can easily reach 20 states to provide a multistate agreement on a compact that we would ask the Congress——

The CHAIRMAN. How many, Governor?

Governor GERINGER. Pardon me?

The CHAIRMAN. How many did you say?

Governor GERINGER. There are 32.

The CHAIRMAN. And you said you could easily reach——

Governor GERINGER. We think we could reach 20, easily, of those 32.

The CHAIRMAN. Thank you.

Governor GERINGER. Thank you, Mr. Chairman.

The states that are in green are observers to the process. They have taken a wait-and-see approach as to how this works out. There are states that are indicated in beige that collect no sales tax and then, of course, the ones that are listed in gray have indicated their—I am not sure what their opposition is to, because I think uniformly all the states agree that we do not want to tax new. We want to adjust how we collect, and enforce the tax collection.

Let me talk a minute, though, about tax and revenue systems at the federal level. When it comes to the shift to the Internet purchase of any kind of product or service, there are federal Internet taxes today, where the states have been somewhat—at least, it is hazy as to whether or not the states are prohibited. I do not know how we would clarify that except through your hand and through your adoption of legislation.

While states have been precluded from taxing Internet transactions, the Federal Government imposes many federal taxes that are being conducted over the Internet. For example, airline tickets, liquor, tires, tobacco. In fact, I have a list of all the federal excise taxes that, as any product that is listed on here shifts to Internet purchase, the Federal Government still collects the excise tax, and you have the enforceability to do it, and the system engaged to do it. The states are asking for an even playing field to do the same. Fair is fair. If the states are prohibited, the Federal Government ought to examine its own approach and prohibit the same collection.

The difference is, the states cannot reach beyond their own jurisdiction, and that is the authority that we are asking for, is the simplification through the adoption of technology, through the use of the Internet, and through the use of standardized software that will allow us to extend our jurisdiction to collect taxes.

The estimate that was given to me is that there is $90 billion a year in a variety of federal excise taxes, many of which are over the Internet. The equivalent would be, over time, the erosion of that $90 billion if the Federal Government were in the same situation as the states currently find themselves in. That is evidence, I believe, Mr. Chairman, that we ought to do something to assure the idea of fairness. It is not just a matter of resident merchants and nonresident merchants. It is a matter of fairness as to how excise taxes are collected, regardless.

The most significant unintended consequence is that traditional business transactions that are taxable today can completely avoid paying taxes in the future by simply setting up an electronic means to complete a transaction that fits the current definition under the Internet Tax Freedom Act, but the need for simplification goes beyond that for our small businesses.

In Wyoming—I believe that the SBA defines a small business as anything under 500 employees. That is a big business in Wyoming, Mr. Chairman. Unequal taxation between in-state merchants and out-of-state merchants means that you will be driving out more and more of our small businesses, particularly those in our smaller states, but in the rural areas of any of our states, for those who can transact remote or electronic sales, and you will force people to migrate to the Internet.

In terms of the impact, Mr. Chairman, the report that I make reference to today is the Forest report of November 2000. They are based in Massachusetts. They estimate that the sales tax losses, just to states, not counting local governments, will total $13.7 billion by 2004, and the most significant sales tax loss could be business-to-business, where today most everyone thinks in terms of the retailing of business to consumer.

Many have suggested that we should just eliminate all sales taxes, and that is certainly very appealing. Let me give you an example now of why energy is a significant issue to Wyoming. We are probably the BTU capital of North America, if all of our energy were developed at one time. Many of our western states are. The difference in Wyoming is, as we shift tax burdens from one to another, we will probably shift it to energy, and if we shift it to energy, it will be the energy that is exported to the rest of the country, and as we talk about the high impact of energy costs today, and the impact on our individual citizens' pocketbooks and what they can and cannot afford, mostly cannot, it would force Wyoming, just to support its current education and health programs, to shift more of its income revenue-raising to energy, and we would export that to others, whereas today our philosophy is, it ought to be user pay. We would be left with fewer options if we are not able to guide our own destiny, if you will.

The Governors recognize the need to simplify the current sales and use tax collection system, and so we support the effort that is being proposed particularly in Senator Dorgan's bill, cosponsored by our own Senator Enzi. We would ask that any extension of the moratorium connect those two concepts: simplification initiated by the states, a compact that could be approved by Congress, and should be, to set up centralized one-stop multistate registration, adopt uniform definitions, relieve sellers from liability on any states errors that might be introduced, use information that is provided by the states—in other words, have a state-level administration of state-level taxes, and we would take care of the local option taxes.

The Dorgan-Enzi bill, sponsored by others, also contains a provision that says first of all there would be a single blended rate to simplify even further anything that might be applicable to remote commerce. The states then would also in that bill have the alternative of requiring collection at the actual rate should they enact all the simplification measures that are enumerated.

So Mr. Chairman, in summary, we are asking for a partnership. We are asking first of all that we clarify the issue to say this is not about new taxes. It is not about taxing access. It is about simplifying our current system, which you have aptly pointed out, is well over 7,000 jurisdictions. We need to simplify. The nature of business today requires it. It is time it were done, regardless, but let us not let the unintended consequence of letting everything shift to the Internet simply to avoid paying of taxes be the way it is done.

We need your partnership. What we do not need is that the marketplace would make its decisions based on arbitrary tax policies. Business ought to be in the true sense of entrepreneurship, where

they make their decisions based on the free enterprise system, not on some taxing scheme.

Mr. Chairman, I thank you again for your courtesies extended. I look forward to your questions.

[The prepared statement of Governor Geringer follows:]

PREPARED STATEMENT OF HON. JIM GERINGER, GOVERNOR, STATE OF WYOMING

Chairman McCain, Senator Hollings, and Members of the Commerce Committee, thank you for your invitation to address issues of state and local taxation authority on behalf of the National Governors Association. I am here today both as the Governor of Wyoming and as the co-chair of the E-Governance Task Force for the National Governors Association.

The hearing notice on your Committee's web page indicated that the purpose of this hearing is "whether Congress should **allow** states to require all remote sellers to collect and remit sales taxes on deliveries into that state, provided that states and localities dramatically simplify their sales and use tax systems." I suggest Mr. Chairman, that the issue is not whether the Congress should **allow** states and local governing bodies, but whether the Congress should **enable** such actions. The answer is "yes."

Since their initial meeting in 1908 to discuss interstate water problems, the Governors have worked through the National Governors Association to deal collectively with issues of public policy and governance. The Association's ongoing mission is to provide a bipartisan forum to help shape and implement national policy and to solve state problems. Today we ask your participation as we begin the process of simplification of taxation at the state, local and federal levels of government.

There's an old saying that "he who defines the issue wins the argument." Part of our work today then, is to decide who has the responsibility and authority to implement new approaches to tax and revenue solutions in the age of the New Economy. I submit that taxation is and should be, the primary responsibility of the states. Preservation of state and local sovereignty is the cornerstone of our government.

Today's Situation

Congress, the states and local governments need to function in the new economy without hindering its continuing expansion. Our economy is changing in fundamental ways and much more rapidly than government's ability to react to it, particularly with regard to taxation.

Electronic commerce is not new. When Marconi invented the telegraph, when Alexander Graham Bell invented the telephone, they initiated electronic commerce. Nobody suggested then that there was something unique that ought to lead the Federal Government to prohibit the states from imposing taxes on transactions conducted using these new industries or later ones such as fax machines.

Likewise, the "New Economy" is not new. It's just more noticeable. It has taken many of our traditional approaches to governing and service delivery by surprise. Each of us in our respective states wants a piece of the new economy and all that it implies—innovation, productivity, enhanced opportunity and income. Technology and globalization are changing the rules in the economy and the traditional domains of federal, state and local governments, particularly in tax and revenue systems.

Our citizens have become so accustomed to access to the Internet for business transactions that they now expect the same from government programs and services. They want to make purchases and to access services independently of time and place. Our citizens want government to be more accountable and responsive to their needs. That expectation has led to more programs being brought back to the states.

That's what citizens want. Now, what do our businesses want? They want uniformity, particularly when it comes to tax and revenue systems. In order to be competitive, businesses don't want to accommodate the existing patchwork quilt of state laws, regulations and tax programs. How can they achieve uniformity? They might ask the states to develop a uniform approach to taxation, or go to the Federal Government to ask for uniform standards or a federally imposed tax. Another option would be to not have any tax on any transaction. What we have today is a blend of all—some transactions with a patchwork quilt of laws and regulations, some with simplified taxes and, the newest one, some with no tax at all. The no-tax-at-all transactions are very appealing, both to the on-line retailer and to the on-line customer. This last category is the result of the Internet Tax Freedom Act, which is currently being interpreted to allow any transaction to be conducted electronically and thus avoid the collection of state or local sales and use taxes.

The Internet Tax and Freedom Act

The Internet Tax Freedom Act (Pub. L. 105–277) was passed in October 1998 to provide the new electronic commerce industry with short-term protection from a burdensome and discriminatory system of state and local taxation. In March 1998, one of the primary sponsors, Rep. Cox (California) held a news conference to announce the support of the National Governors Association, the U.S. Conference of Mayors, the National Conference of State Legislatures, the National Association of Counties, and the National League of Cities for the legislation. Several changes had been made to ease state and local government concerns, including: shortening the moratorium to three years; providing for what was seen as a targeted moratorium instead of a blanket prohibition on all Internet-related taxes; and creating a temporary commission to study the complex state and local tax issues relating to electronic commerce.

State Revenue Sources Focus on Sales Tax

The National Conference of State Legislatures indicates that states collect revenue from three primary sources: sales tax, income tax and property tax. The sales and use taxes dominate, representing anywhere from 27 to 45 percent of state revenues in the 45 states and the District of Columbia that impose transaction taxes. Collectively, approximately 40 percent of all state revenues come from sales and use taxes. Similarly, our cities and other local governing bodies obtain significant revenue from local option taxes.

Our states through our legislatures have figured out how to cut $25 billion worth of taxes over the course of the last decade. How we have cut those taxes has been different in every state, because the people and businesses of each state have different needs and priorities. Many states have shifted reliance away from property tax and broadened (while reducing the rate) the sales tax base in order to provide a much fairer system to invest in public education.

The Federal Government is empowered to regulate interstate commerce, but it would be unwise to usurp the most basic rights reserved to the states as to how they may or may not raise, or lower, revenues.

State Spending Patterns Focus on Children

Taxes finance the highest priority programs for state and local government. The latest survey of state spending patterns shows that states' highest single priority for spending is education, followed by health care and family services. In Wyoming, nearly 90 percent of our budget is allocated to four main areas: education, health, family services and public safety. Any tinkering with our primary source of income will dramatically affect our top spending programs, particularly those that affect children. Actions or even specific inactions on tax issues by the Congress then, can and will dramatically affect our Wyoming priorities.

Federal Revenue

Contrasted to the states, the Federal Government generates revenues almost exclusively from income tax. That makes decisions easy from your Congressional point of view. No harm, no foul. No tax, no problem, since no federal revenue comes from sales or use taxes. Our state and local taxes differ by the choices of those who are governed. Five states do not impose any sales tax. A different number of states do not impose an income tax. My message is simple: the Congress should not dictate an absolute pre-emption of state prerogatives on tax issues. You can and should enable the states to come up with their own approach that will lead to uniformity.

Tax Simplification Criteria

The states have already begun to cooperate to simplify state and local tax systems. Restructuring will enable citizens and businesses to understand which level of government imposes taxes and which provides services. We can and will craft a simplified tax structure that is close to the people, fair to both businesses and customers and equally applicable to all transactions.

Any remedy must be equitable, uniform and non-discriminatory. Proper authority of the states must be preserved. Tax policy should not play favorites, whether between and among states or between and among economic activities. Education, health and public safety issues should not be put at risk.

Tax and revenue systems for the new economy should be cost-effective and customer-friendly, afford flexibility in how standards are met and provide transition as states and locals adapt. Today 7,500 different state and local tax jurisdictions are a nightmare for the private sector. Given this mish-mash, federal standards might be appropriate. However, if we are to lower the cost of tax administration as well as of doing business, we need local innovation. That tips the scale toward state re-

sponsibility. The solution rests with *nationally developed* standards, not *federally mandated* systems.

Federal Internet Taxes

No one has clean hands when it comes to electronic transaction taxes. While states have been precluded from taxing electronic transactions, the Federal Government imposes many federal taxes on Internet transactions or businesses, including excise taxes as well as individual and corporate income taxes. The airline ticket tax increase was a critical part of the Balanced Budget Act of 1997, a tax that was increased again last year. No member offered an amendment to exempt from those federal taxes, domestic or international tickets purchased on the Internet, perhaps because such an exemption would have accelerated the migration of ticket purchases to the Internet. That might have eroded a critical source of revenues to the Airport and Airway Trust Fund. Airport and aviation safety in this country and around the world are dependent upon a reliable source of trust fund revenues. Today, Northwest Airlines reports that 65 percent of its customers use E-tickets with little thought given to the taxes that are collected. Do consumers have to pay a federal excise tax when buying tires, airline tickets, liquor or cigarettes over the Internet? Should we propose federal legislation to not tax the income of any person or corporation which makes its money over the Internet as an incentive to boost Internet activity?

Fair is fair. No state taxes, no federal taxes.

Avoiding Unintended Consequences

The argument that Internet-based fledgling businesses need to be nurtured is not a relevant argument. Electronic commerce has become a mature and important part of the U.S. and international economy. Since the moratorium imposed three years ago, much has come to light on the intended as well as the unintended consequences of the Act. The most significant unintended consequence is that traditional business transactions that are taxable today can completely avoid paying taxes in the future simply by setting up an electronic means to complete a transaction.

Any extension of the Internet Tax Freedom Act must modify the definition of Internet access as contained in the Act. Internet and electronic commerce technologies are experiencing a convergence and becoming indistinguishable from other related communications technologies and media.

The Act protects against the imposition of new tax liability for consumers and vendors involved in commercial transactions over the Internet, including the application of discriminatory tax collection requirements imposed on out-of-state businesses through interpretations of 'nexus.' It also protects from taxation, for the duration of the moratorium, goods or services that are sold exclusively over the Internet with no comparable offline equivalent.

This effectively allows a broad range of content and other services to be bundled with Internet access and to potentially be considered as protected under the prohibition on the imposition of new taxes on Internet access. The range of content, services and even goods that can be bundled with Internet access is virtually unlimited. It includes all manner of printed material, video material, voice communications and other services. As the Internet technology converges with services such as telecommunications and cable television, it will become increasingly difficult to distinguish one from another. Today, one out of every 33 international long distance calls is handled over the Internet. A draft report from Geneva last week projects this level to increase from 3 percent today to between 25–40 percent over the next five years. Yet, different service providers could be subject to widely different tax regimes because of the intervention of the Internet Tax Freedom Act.

The Need for Simplification

The states recognize the problem of unequal taxation between in-state merchants and out-of-state merchants, nearly all of whom now use the Internet for a variety of business practices.

In-state merchants who must collect sales/use taxes are at a disadvantage with merchants who transact remote or electronic sales. It's not that the remote or electronic sale is exempt. It is not. Every state that levies sales taxes requires a use tax to be paid if a customer purchase is made on-line or out of state. It is a consumption tax on the consumer, not the vendor. Under current legal standards, a state may only impose sales and use tax *collection* requirements on sellers with a physical presence, or nexus, in the state whether the transaction is over the Internet or not. This means that remote sellers (i.e., sellers outside the state without a physical presence in the state) are able to fully exploit the market in that state—whether by mail, telephone or the Internet—without being required to collect or

remit tax on their sales into the state. Sellers that are physically present in the state are required to collect and remit the tax.

The remote merchants are quick to point out that they have to charge shipping and handling and that cancels their advantage over the in-state merchants. That ignores the fact that in-state vendors have already included shipping and handling in their pricing. The in-state merchant not only has to charge and collect the tax but is also responsible for reporting and remitting it and becomes liable for the tax if an audit indicates inadequate collection and remittance. We fully support unfettered interstate commerce but as a matter of basic fairness, similar transactions of goods and services should be treated similarly no matter what means are used to effect the transaction.

Not collecting the use tax on electronic transactions would be an incentive for merchants to use electronic or Internet transactions. States are concerned that Congress' actions or inaction could lead to accelerating the erosion of sales and use tax revenues as the nature of the retail industry evolves. We have learned that one of the nation's largest retailers has entered into an agreement with one of the nation's largest e-tailers. This arrangement could permit a means to avoid sales taxes. For example, Mr. Chairman, someone in Arizona might wander into a store, pick out a nice pair of Levis, and instead of pulling them off the rack and paying for them at the counter, might now use an in-store Internet kiosk to place an order. Then he could go to the counter and pick up his purchase with no liability for state or local tax, since under the Internet Tax Freedom Act definition, it would be a remote sale. Under such a system, one can imagine just how long it would take for every brick and mortar retailer in America to migrate to some form of in-store system simply to compete.

If such a scenario were to play itself out, state sales and use tax systems would become obsolete and inefficient for raising revenue for the state and local governments. While the prospect of no taxes at all is certainly appealing, we are prepared to offer a more pragmatic alternative.

The definition of discriminatory taxes contained in the Act provides that certain activities when performed by an Internet service provider on behalf of a retailer will not be considered in determining substantial nexus for tax collection purposes. When enacted as part of a short-term Act, these provisions were not considered problematic. If the Internet Tax Freedom Act is to be extended, however, these provisions should be examined carefully. The provisions could be interpreted to allow a seller to avoid a collection obligation even though the seller has substantial activities and presence in the state.

The Growth of eCommerce

We support the free flow of commerce and equal competition in the marketplace. The accounting firm Ernst & Young predicts that consumers will use e-commerce for five to ten percent of retail sales in the next five years. Goldman Sachs predicts inroads of 25 percent in ten years. Even these could be significant underestimates. Business-to-business e-commerce is growing far faster than popular on-line consumer purchases. Business-to-business e-commerce is expected to reach $1.3 trillion in annual revenue by 2003, ten times the projected size of the business-to-consumer market. That's very much why the National Retail Federation, representing some 1.5 million members and nearly one in every five workers, voted last week for fairness.

It's also why my distinguished colleague Governor Gilmore's proposal would preserve business-to-business use taxes on Internet transactions. He clearly understands the enormity of the adverse impact on his budget and education and transportation commitments to the high tech businesses in Virginia were he to lose this critical source of revenues. This tax is too important not to work hard to save it in its broad application.

The Governors recognize the need to simplify the current sales and use tax collection systems to benefit the national economy through the removal of unnecessary complexity. We now have agreement by some 32 states on model state legislation and an interstate agreement through the Streamlined Sales Tax Project. States and their local government partners have taken the initiative to fashion a solution.

Tax Simplification Recommendations

States that enact the model legislation and that dramatically simplify their sales tax systems should have the authority to require out-of-state sellers to collect and remit sales and use taxes. States that do not enact model legislation would be stuck with the old ways. The fact that we have 40 states that are willing to simplify their systems and dramatically reduce the complexity and cost of collection for all sellers is evidence of our commitment to adapt to the new economy. While the project still

has work to do, a model Administrative Act was completed with Wyoming the first state to approve it last month. The project will continue to refine the terms in its second phase this year.

The Wyoming simplifications, which are the same as recommended by the Streamlined Project include:

- centralized, one-stop multi-state registration;
- uniform definitions for goods and services;
- uniform rules for attributing transactions to particular taxing jurisdictions;
- uniform and simplified rules for dealing with exempt transactions;
- procedures for relieving sellers from liability to the state for errors resulting from use of information provided by states;
- certification of software that sellers may use to determine tax due on transactions;
- uniform rules for claiming bad debts;
- uniform formats for returns and remittances, including electronic filing and remittances;
- state-level administration of all state and local sales and use taxes; and,
- uniform audit procedures, including the option for a single, multi-state audit.

The Streamlined Sales Tax Project has even developed a system that would accommodate local option tax rates but, at the same time, reduce the burden of administering those rates for remote sellers and other retailers. The streamlined system would require each state participating in the system to provide sellers with a database that assigns nine-digit zip codes to taxing jurisdictions and to relieve sellers from liability for any tax not collected due to a seller's reliance on the information provided by the state. The system would also limit the frequency with which local tax rates may be changed and requires advance notice of these changes.

Wyoming Senator Mike Enzi has advocated a single blended rate for each state that would be applicable to remote commerce only. States would also have the alternative of requiring collection of the actual rate rather than the blended rate when a state has enacted all simplification measures enumerated in the bill. We support this two part approach.

The states are working to implement these simplification measures. When an appropriate number of states do agree to a common approach through an interstate compact, we expect Congress to grant states the authority to impose the duty to collect on remote vendors.

Partnerships

We propose a partnership between the states and the Federal Government to authorize the states to mandate collection and remittance of use tax by remote sellers but only for those states that have enacted the radical simplification measures recommended by the Streamlined Sales Tax Project. The Governors would favor a sales threshold below which remote sellers could not be required to collect use taxes, otherwise known as the *de minimis* provision. Collection duty would then be tied to volume of business rather than location, which is more in keeping with a free market economy.

We recommend that Internet access be defined in a fashion that achieves the Congressional goal of protecting basic access to the medium and services of the Internet without being so broad as to create inequities and distortions. The Governors recommend that the Committee establish some mechanism to examine and address the issue of bundling and convergence in the near future.

The Governors recommend that Congress should use any extension of the Internet Tax Freedom Act as an important opportunity to enact legislation establishing a procedure that would encourage states and localities to continue their initiative to develop and implement a simplified and streamlined sales tax system. Those states that do simplify their sales tax systems to require remote sellers could then collect sales and use taxes on sales into a state.

The Governors support the simplifications contained in S. 521 introduced in the U.S. Senate on March 9 to reduce the burden of state and local sales tax compliance and to save the nation's economy millions of dollars through streamlining our current horse and buggy tax system. The simplifications in the bill are consistent with many of the efforts now being undertaken by the Streamlined Sales Tax Project. The project has completed what it considers the first phase of its task with the development of a model statute and accompanying agreement that states would enact

to implement a much simpler multistate sales tax system. The system provides all of the simplifications contained in S. 521.

Congress should support and encourage this extraordinary effort by the states and local governments. We recommend that you authorize an interstate compact that extends the authority to require collection only to those states that simplify their tax systems. The structure embodied in S. 521 is appropriate for accomplishing this. The authority to require collection would be automatic for those states enacting the compact with the simplified structure.

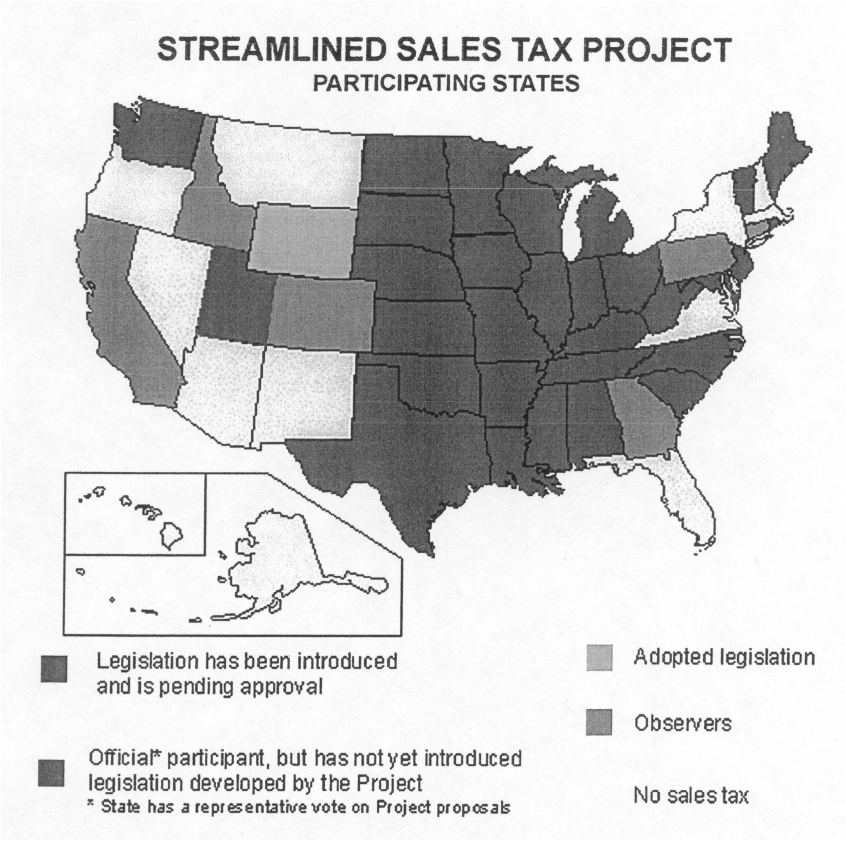
Conclusion

States must be allowed to determine our own revenue policies under the laws the people of our state have adopted and we are elected to implement. Most sales taxes have been in place for at least 50 years. The system is an unwieldy horse and buggy system of another age. We are moving to fix it, to radically simplify the system so that it works.

Federal Reserve Board Chairman Alan Greenspan in his remarks to the Committee on the Budget, U.S. House of Representatives, March 2, 2001 spoke of the unusually long period of economic growth in America. He spoke of technical innovation and structural productivity growth driven by individual creativity, of how the rate of growth of productivity in the past five years has far exceeded the growth rate of the previous twenty years. Much of that growth has been fueled by activity through the Internet. Chairman Greenspan pointed to the sustainability of our economic growth as being tied to Internet activity. He warned against actions by government that would discourage innovation and stifle productivity growth. Likewise, I caution this Committee against recommending an approach that would stifle the states by prohibiting certain taxes and forcing the imposition of others.

We need to let the marketplace make the decisions of which businesses succeed and which businesses fail. Let us not set arbitrary tax policies for the states at a federal level. That is wrong and unfair. That would only force people to make their decisions based on the taxing scheme and not the free enterprise system.

Thank you, Mr. Chairman, and Members of the Committee for your courtesy. I would be pleased to respond to any questions or comments.



The CHAIRMAN. Thank you, Governor, and I would like to congratulate you on being one of the first states, I believe the first to pass a uniform sales tax proposal, and I think it is a very commendable and laudable action on the part of you and the Wyoming State legislature. Thank you, Governor.

Lieutenant Governor Swift, welcome.

STATEMENT OF HON. JANE SWIFT, LIEUTENANT GOVERNOR, COMMONWEALTH OF MASSACHUSETTS

Ms. SWIFT. Thank you very much, Mr. Chairman, and thank you to the Members of the Committee for giving me this opportunity to speak with you today on this very important issue. I am Jane Swift. I am the Lieutenant Governor of Massachusetts, and this is an issue of particular importance to my home state, and that is why I am so glad to be able to be here today to speak on behalf of our residents.

Massachusetts has been at the leading edge of the high technology revolution, and our residents have been the ones that have benefited tremendously from the infusion of high tech jobs into our state. Currently, there are 185,000 nonmanufacturing high tech-

nology jobs in Massachusetts, an increase of roughly 20,000 such jobs since last year.

These positions represent well-paying, quality jobs that allow people truly to live the American Dream, to support their families, and to enjoy a quality of life that no numbers could readily quantify.

Over the past decade, these types of companies have brought new life to aging mill towns throughout our state, like North Adams, and Lowell, and have helped drive the longest economic expansion in American history. I am deeply concerned, as is our Governor, Paul Cellucci, that attacks on Internet growth will serve to hinder the very growth in this very important sector at a time, as you reference, Mr. Chairman, that it can least afford it.

The proper role of government in this emerging industry is to encourage its growth. It would be a grave mistake on our part to start taxing Internet commerce before it has had even a chance to establish itself. We have seen a precipitous decline in the NASDAQ over the past year, and as I am sure everyone here is aware, just this week it dipped below the 2000 mark for the first time since 1998, and we do not see signs of recovery in that industry in the near future.

Some dot coms that were once the toast of Wall Street are now auctioning off the remains of their companies and the imagined threat to brick-and-mortar stores has all but disappeared. While other segments of the high tech sector have been able to offset these company closings, it would be a mistake to drive remaining businesses out of business through added taxes. That would be the equivalent of tossing them an anchor at a time when they need a life vest.

Passing a tax on Internet sales will put people in my state out of work. The reality is that the impact of Internet sales on current state revenues has been negligible. In Massachusetts, the impact of Internet commerce on traditional retailers has been nearly insignificant. Retail sales this past holiday season and sales tax collections held steady, despite some signs of a slowing economy. We found that the positive effects of high technology sectors have far outweighed the perceived detriment to local retailers or to state sales tax revenues.

These firms have rejuvenated crumbling cities and have provided high quality high-paying jobs to thousands. This is the kind of economic activity we need to develop across the country, and I fail to see how taxing that activity will provide that needed encouragement.

Most of the concern I think has been widely recognized. The concern behind the push for Internet taxation came from state fears that dot com companies were taking over the economy and that there would be no traditional sales tax revenues left. This has just not been the case. Despite the Internet, people still leave their homes to go shopping. Brick-and-mortar stores will always have their place in our communities. They also provide jobs, and they also provide the personal touch that people will always desire, as well as the immediacy of not having to wait for a purchase to be delivered.

Beyond the detrimental effect that Internet taxation will have on this growing segment of the high tech economy, I also question the wisdom of plans that are as complex as those proposed by the NGA. The complexity of these interstate sales taxes is something that I do not believe the government should be undertaking. With all due respect to my colleagues from the NGA, I am not sure that establishing a large bureaucracy to deal with online sales taxes is what this country needs. It seems to me that one IRS in Washington is enough, and we do not need a second.

The necessity of federal bureaucracy or online taxation also, I believe, raises another important issue that I hope your Committee will consider as you look at this issue, which is the issue of privacy. I do not believe that people want the government keeping track of every item they purchase online, nor do I believe that this Orwellian oversight would encourage the sales of current electronic retailers. Internet companies have to address privacy and security concerns, and big government involvement I believe would make that considerably more difficult.

Customers who may not be driven away by the tax complexity may, in fact, then be driven away by their concerns for their personal privacy. I would just request that all of the Members of this Committee look at the long-range benefits of growing our high tech economy, consider the ramifications of burdening that sector with this complex tax system, and I hope you will come to the conclusion that Governor Cellucci and I have, that any short-term revenues do not make up for the economic costs of restricting Internet growth. Governor Cellucci and I have, I think, been very public in stating we believe there should be a permanent ban on Internet taxation.

Let me, if I may, just also address this issue of a level playing field for out-of-state sales transactions. It would seem to me that were we to adopt this system on remote sellers that is being discussed and is being put forward by many of the national Governors, that a level playing field would dictate that it apply not just to remote sellers, not just to online sellers, but offline, or brick-and-mortar companies as well.

The truth is that today, particularly maybe more in states like Massachusetts, that are relatively small geographically and have borders that people cross quite easily, we do not place the burden of sales tax collection on the seller. If a state resident of Massachusetts crosses the border into another state, whether it be New Hampshire or Vermont, Connecticut, New York, Rhode Island, it is not the small company there who is asked to determine where that person's residence is and to determine what the applicable sales tax collection should be. It is, in fact, the responsibility of the buyer, through use taxes, and it is the complexity of trying to enforce that has, in fact, made, as Governor Geringer said, the collection of use taxes widely unenforceable.

If we are talking about a truly level playing field, then when a Massachusetts resident would travel to Jackson Hole, Wyoming, and purchase an item in a small brick-and-mortar retail establishment that would be subject to Massachusetts taxes, then the logical extension of this argument would be, it would be the responsibility of the retailer in Wyoming to collect the appropriate Massachusetts sales tax. I do not believe that is something that would be sup-

ported by a majority of small employers and small brick-and-mortar businesses across the country. We are talking about shifting the responsibility to remote sellers, to those sellers rather than to the buyer and, in fact, subjecting businesses in our state to burdensome tax regulation that we have found would be a detriment to the growth of our economy, and we think it should be our prerogative to reject that type of system. Thank you.

[The prepared statement of Lieutenant Governor Swift follows:]

PREPARED STATEMENT OF HON. JANE SWIFT, LIEUTENANT GOVERNOR, COMMONWEALTH OF MASSACHUSETTS

Thank you, Chairman McCain and Members of the Committee for giving me this opportunity to speak with you on the important issue of Internet taxation. This is an issue of particular importance to my home State of Massachusetts, and I am glad to have the chance to speak here on behalf of our residents.

Massachusetts has been at the leading edge of the high-technology revolution, and our residents have benefited tremendously from the infusion of high-tech jobs into the state. Currently there are 185,000 non-manufacturing high technology jobs in Massachusetts, an increase of roughly 20,000 since last year. These positions represent well-paying, quality jobs; jobs that allow people to live the American dream, support their families, and enjoy a quality of life that no numbers can quantify. Over the past decade, the presence of these companies has brought new life to aging mill towns like North Adams and Lowell, and has helped drive the longest economic expansion in American history.

I am deeply concerned that a tax on the Internet will serve to hinder growth in this important sector at the time when it can least afford it. The proper role of government in this emerging industry is to encourage its growth. It would be a grave mistake on our part to start taxing Internet commerce before it has even had a chance to establish itself.

We have seen a precipitous decline in the NASDAQ over the past year. This week it dipped below the 2000 mark for the first time since 1998, and has shown no signs of recovery in the near future. Some dot-coms that were once the toast of Wall Street are now auctioning off the remains of their companies, and the imagined threat to traditional brick and mortar stores has all but disappeared.

While other segments of the high tech sector have been able to absorb some of these company closings, it would be a mistake to drive remaining businesses out of business through added taxes we don't need. That would be the equivalent of tossing them an anchor when they need a life vest. Passing a tax on Internet sales will put people in my state out of work; and they would be losing their jobs just because government can't keep its hand out of the cookie jar.

The impact of Internet sales on current revenues is negligible. We have found in Massachusetts that the impact of Internet commerce on traditional retailers has in reality been nearly insignificant. Retail sales this past holiday season held steady, despite some signs of a slowing economy.

We have found that the positive effects of high technology sectors have far outweighed any perceived detriment to local retailers or to state sales tax revenues. These firms have rejuvenated crumbling cities, and have provided high-quality, high-paying jobs to thousands. This is the kind of economic activity we need to develop across the country, and I fail to see how taxing that activity will provide the needed encouragement.

I am especially skeptical of the need for increased taxes at a time when state revenues have been reaching record highs. I believe now is the time to lower the tax burden on our citizens, not raise it. Republican Governors have worked hard over the last decade to cut tax rates for the citizens of Massachusetts, and I would encourage the Senate to act to cut federal taxes as well.

Most of the concern behind the push for Internet taxation came from state fears that dot-com companies were taking over the economy, and that there would be no traditional sales revenues left. This has not been the case. Despite the Internet, people still leave their homes to go shopping. The new economy juggernaut has slowed to a walk, and most people have realized that previous fears of an economic revolution were unfounded. Brick and mortar stores still have their place in our communities. They also provide jobs and they provide the personal touch that people will always need, as well as the immediacy of not having to wait for a purchase to be delivered.

Beyond the detrimental effect that Internet taxation will have on this growing segment of our high-tech economy, I also question the wisdom of plans that are as complex as that proposed by the NGA. The complexity of these interstate sales taxes is something that the government should not be undertaking. With all due respect to my colleagues, I am not certain that establishing a large bureaucracy to deal with online sales taxes is what this country needs. It seems to me that one IRS is enough for Washington. We don't need a second.

The necessity of federal bureaucracy for online taxation also raises substantial concerns over privacy issues. I do not believe that people want the government keeping track of every item they purchase online, nor do I believe that this Orwellian oversight would encourage the sales of current electronic retailers. Internet companies have to address privacy and security concerns, and big government involvement makes that considerably more difficult. Customers who aren't driven away by the tax, may be driven away by their concerns for privacy.

I would encourage all the Members of this Committee to look at the long-range benefits of growing our high-tech economy, and consider the ramifications of burdening that sector with further taxes. I hope that you will come to the conclusion, as I have, that any short-term revenues do not make up for the economic cost of restricting Internet growth. I would encourage you to enact a permanent ban on Internet taxation.

The CHAIRMAN. Thank you very much. We obviously have a significant difference of opinion here between the two witnesses. We do have another panel, and we have a vote at 10:45. If there are questions for the Governor and Lieutenant Governor we would be glad to entertain them, recognizing Senator Dorgan first, and I would ask the members to make the questions fairly brief, because we have a whole other panel. We are going to have to break at 10:45 and that is going to extend the hearing for a significantly long time.

Senator Dorgan.

Senator DORGAN. Mr. Chairman, I understand that, and we want to make sure we hear the other panel, so I will be brief.

Let me ask Governor Swift, you indicated, I quote, "passing a tax on Internet sellers would be a death knell, et cetera." You understand that the discussion and debate and legislation here is not about passing a tax on Internet sellers, do you not?

Ms. SWIFT. Well, what I understand is that it would subject those sellers who may have a physical location in my state to a complex tax system that they would then be required to implement that we think would restrict their growth, as is not currently the case in most jurisdictions for brick-and-mortar businesses. We do not subject that person who is selling the product to determine the residency of the person who is purchasing it.

Senator DORGAN. But, so you do understand, we are not talking about passing a tax on the Internet, which is your testimony. We are talking about requiring a collection on behalf of sellers.

Ms. SWIFT. I think it does give new authority. I do understand that it would give new authority to the states to require companies who do not have a physical presence in their state to become the collector, and while you may say that is not a specific tax on the Internet, it would subject those companies to all the tax regulations, to the audits, and to the complexity of a system that I think would be detrimental to their growth.

Senator DORGAN. I understand your point. I just want the language to be accurate. The tax already exists. You understand that. The tax exists. It is not collected. I do not want people to talk about Congress talking about imposing some new tax, which was in your

testimony, passing a tax on Internet sales. That is not what this discussion is about. Enforcing the collection of a tax that already exists.

Second, let me ask——

Ms. SWIFT. But I do think it would extend taxing authority that does not currently exist.

Senator DORGAN. Well, let me—that is not the case at all. The taxing authority exists. It is a use tax authority that exists on the transaction of those sales. The question is, is it collected? Governor Geringer said no. He is accurate about that. It is almost never collected.

So this is not a new tax. The tax already exists. It is about collection of tax.

But let me ask one additional question on the issue of, you talked about the necessity for a federal bureaucracy and big government involvement. Could you describe that, because that is—you are winning a debate we are not having.

[Laughter.]

Ms. SWIFT. Well, I think the concern is, while we talk about simplification of the tax system, we have yet to see evidence that would happen and, in fact——

Senator DORGAN. I am talking about the federal bureaucracy. Could you describe what that bureaucracy——

Ms. SWIFT. Well, my concern is who would ultimately—if Congress makes the decision that, in fact, they are going to allow through interstate commerce there to be a taxing authority, a tax collection authority for states, with states that do not have a physical presence, then whose responsibility would it be to do the enforcement?

Senator DORGAN. The states.

Ms. SWIFT. Whose responsibility would it—so Massachusetts could be told by Congress that we have to enforce—I mean, I think that is the essence of the debate.

Senator DORGAN. Well, you are misunderstanding—Governor Swift, with due respect you are misunderstanding this issue. No one is telling Massachusetts you have to do anything. The question is, will the Congress allow Massachusetts to be able to effect collections. It is the testimony of Governor Geringer—you apparently oppose it, but it is not enforcing anything on anybody with respect to the state governments, and I only raise this question because when you talk about the establishment of a new federal bureaucracy, no one is talking about anything that remotely resembles some sort of bureaucracy of the Federal Government. This would only empower the state revenue agencies.

Ms. SWIFT. Let me just be very clear. I think the threat of that is a real one. For example, if Massachusetts chose not to enforce, for their businesses that are located there, the remote sellers who have a physical presence in our state, that we were not going to go out and use our Department of Revenue to enforce collections that were supposed to be made in Wyoming, then who would have jurisdiction? Would the Department of Revenue, or whatever their name is in Wyoming, have then jurisdiction to come into Massachusetts, to Massachusetts businesses, not to Massachusetts buyers, but to Massachusetts businesses, and if not, then it would be

unenforceable. There has to be some entity that would have to be created to make it enforceable, particularly if not every state agreed with the premise.

Senator DORGAN. Governor Swift, the State of Massachusetts has a right to decide not to enforce any tax laws you enact. You can do that. I assume your constituents would not like it very well, but this issue is not about forcing Massachusetts or any state to do anything. The issue here is about a tax that currently exists and is not collected, and the proposition that we are making is, if we require the states to substantially simplify the requirements here, should we then require the collection of those taxes.

It would be up to the state to effect those collections, not some federal bureaucracy, and I just object to this issue of big government involvement, quote, federal bureaucracy, because as I said, you are winning a debate we have never had and will not have, because that is not what we are discussing today.

Ms. SWIFT. I think—and I take your point, Senator. I think it is important to point out that as we enter into what would establish new taxing authority that there are a variety of threats that all should be considered, because we have not previously had to deal with this issue, and as the complexity of commerce changes, we want to make sure there are not unintended consequences to the decisions that we make today, so that was the intention of my remarks.

The CHAIRMAN. As I feared, we are about to begin a debate that may best be suited for the floor of the Senate, but Governor, former Governor, Senator Allen.

[Laughter.]

STATEMENT OF HON. GEORGE ALLEN,
U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Mr. Chairman, thank you. It is good to see my former colleague, Governor Geringer here, and they have some great stores there in Jackson Hole, Wyoming, and my wife has some beautiful clothes from there, good prices, and we like Cheyenne Outfitters as well.

The CHAIRMAN. Senator Allen, we are going to restrain you to 3 minutes.

[Laughter.]

Senator ALLEN. The great thing about Cheyenne Outfitters, even though you do not buy things over the Internet, it is a catalogue, and they are not compelled by Virginians to collect sales taxes.

I think the issue, Mr. Chairman, as I understand this Committee, is not all—and I enjoyed listening to Governor Swift's remarks, and generally my view is similar to that of Governor Cellucci's, and his predecessor, Governor Weld. The issue I think, Mr. Chairman, before this Committee is whether or not to extend the moratorium on access taxes on the Internet. That advisory commission fought over this issue for a long time, and the one thing that they could agree on was extending the Internet moratorium, first and foremost.

In my view, it should not be a moratorium extended for 5 years. I think the moratorium on taxing access to the Internet should be made permanent. We do not need to create another Spanish Amer-

ican War luxury tax which would impede the ability of people to get access to the Internet, especially when people think of broadband access, or high-speed access.

To me, increasing, or allowing further taxes by states, municipalities, or other entities I think would be very harmful for the expansion of the Internet, which I look at as the modern-day Gutenberg Press for the dispersement of ideas and beliefs and commerce and education, so in my view we ought to have a permanent extension on the moratorium.

Now, the issue of getting into simplicity as far as the harmonization of various sales tax laws in the nation, implicitly says if the states and localities could get together and get a similar sales tax regime, then the issue of the nexus or the physical presence does not matter so much, and it seems to me that does still matter, and I think it will be a very long day before you can get all the states, whether it is Wyoming, or Tennessee, or Texas, or California, or Virginia to agree on the same sort of tax policies.

So I would ask the two witnesses, the issue before this Committee is whether to extend the moratorium on access taxes. In my view, it ought to be extended permanently, and we ought to repeal the Spanish American War telephone tax.

The issue of simplification ought to be completely separate from this, and would you all agree that the issue of simplification could go forward as an independent matter for the states to determine from the issue of whether or not the moratorium, which is going to expire in October of this year, should be made either permanent or extended for 5 or 6 years?

I would first go to Governor Geringer.

Governor GERINGER. Mr. Chairman—and thank you, Senator-Governor Allen.

[Laughter.]

Governor GERINGER. What you may have missed is that my testimony implied, if it did not outright state, yes, we agree with the extension of the moratorium on access. The question is, how will the states be able to continue their current system of taxation, which they rely on heavily, or will be able to simplify it as they go along so they can modernize government approaches at the same time business is modernizing its approaches, so what I have advocated is less government, lower taxes, and simpler ways of doing business.

It is a pretty neat package. There would be less bureaucracy at the state level. There would be no federal bureaucracy. It would all work out in the end because the states would get together and make it work.

The thing that seems to be missed here is, why we are coupling the issues together of allowing the states to determine what a remote sale is, and to be able to collect a tax that is already due. It is a use tax that already needs to be paid, just as Virginia collects business-to-business sales taxes today, even those done over the Internet. We are talking about those that are eroding, if you can package it correctly and be in compliance with the current Internet Tax Freedom Act. That needs to be clarified.

If you are going to extend the moratorium, extend the Wyden bill, whether it be 5 years or indefinitely, you have to clarify this

misunderstanding, or misinterpretation that is allowing retailing today and business transactions to migrate to the Internet and avoid currently obligated taxes.

Senator ALLEN. But there is—I would say to the Governor, they are still subject to the use tax, and what the issue here is whether or not we are going to impede Internet transactions simply to make it convenient for the government, or should the government adapt to new technology?

Governor GERINGER. What I would suggest, then, is that you also extend that same authority to repeal all the federal excise taxes. Here is the document that documents them all, $90 billion a year. $90 billion a year that you would give up. In the current debate over the sales tax, or the tax cut, the package from the White House, this over 10 years would be $900 billion. The debate today is even far less than that.

What is the difference between the Federal Government, that allows the collection and enforcement of taxes on the Internet for their purposes, but will not permit or enable the states to do the same on their own, so if a remote sale is transacted, and the use tax is due in Wyoming, we cannot collect it, just as the other 32 states who have already signed on, they say they believe in this simplified approach, another eight in May, that is pretty popular right there. They have already worked out a simplified approach.

We are asking you to engage in prevention. The crisis is not here. The crisis could be coming. I guess there is more credit given to recovering from a disaster than from preventing it in the first place, but we are asking for some judicious partnership up-front to allow the states to proceed on their own, which is a good idea.

Senator ALLEN. Well, I would like to get rid of the federal telecommunications tax. I see the red light is on, so I want to respect that.

The CHAIRMAN. I think perhaps we would give the Lieutenant Governor a chance to comment.

Ms. SWIFT. I would just say, we would absolutely support an extension or a permanent ban, preferably, on the moratorium on the access tax, and I would agree with you, Senator, that it should be up to the states, not an act of Congress, to have the states proactively act as I understand is probably the intent of Senator Wyden's bill to achieve simplification, although I hate to be a skeptic, but I have my doubts that it would happen, but that does seem to be the fairer way to proceed than to shift the burden of collection to a technology entity that I think has provided great benefits, at least for the economy in Massachusetts.

The CHAIRMAN. Further questions? Senator Wyden. Oh, Senator Kerry, did you want to make any——

Senator KERRY. Thank you, Mr. Chairman. Let me just say, I guess this is part of the debate we are having on this Committee with my colleagues here as we have been trying to sit down privately to work through this, but I guess Senator Wyden and I have a disagreement over the interpretation of the Supreme Court decision, which is really why we are here.

There were two components of the decision. One, I agree with my colleague, talks about the nexus necessary in a taxing state in order to collect sales and use tax, but it says very clearly—let me

just read from it—it says, Congress is free to disagree with the Supreme Court's evaluation of the burdens that use taxes impose on interstate commerce, and Congress remained free to decide whether, when, and to what extent the states may burden interstate mail order concerns with a duty to collect use taxes.

So I think, you know, the question here is, what can the states do in order to remedy what they perceive, maybe not every state, but most states are currently perceiving as an inequity in the marketplace?

I have personally walked into some stores where the owners of the stores have said to me, you know, Senator, I got people coming in here now, and what they do is, they go through all my stuff in the store and they use my salesman, and they figure out exactly what works for them best and what they want, then they go out—they do not buy here. They go out and they use the Internet, and they buy it on the Internet, and this store owner was actually complaining to me personally about this inequity, replicated, I have heard, many times in many places.

Now, the obvious question is, what happens if all of a sudden Congress embraces this concept of permanency, and a tax that already exists, a sales tax, suddenly finds a kind of haven, if you will, the kiosks that we have heard about?

Some people have talked about going to Wal-Mart, setting up a separate Wal-Mart kiosk, you go in, you look at all the things you want to do, then you come out and you pump it in on a computer, and you pump it into a remote selling place where they fill the order and you do not pay a use tax, a sales tax on that.

If we entered into this so-called notion of permanency, we would be creating a sort of institutionalized divide between ways in which people can choose to buy, and I think, Governor Swift, you would agree with me that we already have a lot of people in Lowell, and Lawrence, and Haverhill and elsewhere who take advantage of the proximity to the border. One of the complaints I have heard for years in that northern sector of Massachusetts is, you know, sort of the differential between New Hampshire and the incentive to buy elsewhere. What we are trying to do, I think, is see if we cannot even this out.

Now, Governor Geringer, share with me in the simplest form possible what you see here as the issue of fairness, and how this has impacted your state. Why do you think we need some sort of remedy to adjust this if, as Governor Swift suggests, it is not that serious a problem?

Governor GERINGER. Mr. Chairman and Senator, the impact to any small business is very much as you described it, except it would be magnified significantly more. Wyoming is very well-connected to the Internet. It has been one of the chief things I have advocated, so people all across the state are very connected. Our schools are not only connected to the Internet, they are connected to each other so we can do a lot of teaching. It is inoculated into our whole society. We advocate that because of the productivity it brings.

It has been a disadvantage where it is hard to the businesses that would engage in any kind of a transaction, particularly of goods, but even of services, where, as you describe, somebody comes

into the store, they browse through everything—in fact, even after they have bought it off the Internet, they try to return it to a local retailer. When you talk about, even the larger retailers, who look at a 2-percent profit margin overall, and in our state they might be able to save 5 percent by not being able to charge taxes, that is a very significant purchase.

The current federal excise taxes would allow for tractors—and our state has a few tractors out there in some of the rural areas. You could buy your tractor over the Internet and avoid paying 5 percent on a tractor that probably costs $100,000. That is a very significant impact to a small implement dealer, and that might be his entire week's income.

That is the type of thing that we are looking at, and that is the same person who is expected, then, to help maintain that tractor when the person brings it in for servicing or repair.

So it is a question not of, how do we create a bizarre, perverse incentive by allowing people to avoid paying taxes through an Internet transaction or remote sale, any electronic means of transaction versus what they would pay otherwise. We have to even it out for any small business.

As far as collecting that tax, if the vendor is small and they are engaged in business, the concept that the NGA supports would be the de minimis rule, where if you have sales below a certain amount, a certain threshold, you would not be required to track and help collect that same tax that is done in-state now, so there are some practical limits to what we are proposing here in order to achieve simplification.

Senator KERRY. Thank you. My time is up.

The CHAIRMAN. Thank you, Senator Kerry. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

First, Governor Geringer, let me say again, as the Senate sponsor of the Internet Tax Freedom Act, I am very anxious to work with you and the Governors and our colleagues to try to come up with a sensible approach to this area, and let me offer what I think is the central question in terms of our being actually able to work out a bill and work with all of you in a cooperative fashion.

We have now talked about the two elements in the Supreme Court case. I do not quarrel with Senator Kerry's analysis in the least. The Court said you have got to have physical presence to impose a tax, and they said Congress through the Commerce Clause can make decisions in this area as well.

What concerns me is the process wherein in effect the states would let the horses out of the barn here at a time when the technology economy is very fragile, and Congress would then have to come back and disapprove your plan. What I call for in my legislation is essentially the opposite. We give you all the tools you need, and the time you need to go out and put your plan together and address these uniformity and simplification issues, and then when you have done it, we would have an up or down vote on the floor of the U.S. Congress.

What is the problem with going the route that I envisage in the legislation I proposed, rather than the situation where, without a vote of the Congress, we in effect overturn a Supreme Court deci-

sion as it relates to the physical presence issue? Could you give us your thoughts on that?

Governor GERINGER. Mr. Chairman, it reminds me of a cartoon I saw once where an individual standing in the middle of Wyoming prairie, and he is holding a rope in his hand, and he said, let me see now, did I lose my horse or find the rope? I think that may be part of the question here. I do not think the horses are out.

What we are asking for is a partnership. The question you phrased is, should we let the states come forward with a plan that could be rejected or accepted by the Congress, but by what criteria? What criteria would we work against?

Senator WYDEN. We are happy—and that is one of the things that has been so good about the progress with Senator Kerry and Senator Dorgan and the chairman, I think we are very willing to work with you on those criteria so you are not just flailing around in the dark. The difference, though, is that before it kicks in at a time when the technology economy is so fragile, we would first have to have a vote. We are happy to work with you, to make sure that the criteria are fair.

Governor GERINGER. But I think you take that vote when you pass either your bill or the Dorgan bill, or whatever bill comes along, which outlines a one-stop system definition for how you describe a sale, which could be exempt, what software could be adopted, so you have standardized approaches, simplified, less expensive, uniform tax returns, the use of the Internet for electronic filing, uniform auditing procedures—those are criteria that could be used, but the extension without further definition is risky.

And here is another example that we have not talked about yet. With the emergence of what is called convergence, where you can package up all types of things to offer online, items that are currently taxed and offered for sale as a taxable item are going to be packaged as part of an Internet service. Now, how do you differentiate between what is sold as merchandise over the Internet now, and what is included as an overall package, such as staying in a hotel here in Washington and avoiding the tax, because you bought it online? That is the difference that we have not even talked about yet. How do you even describe that?

The states have already developed a simplified taxing approach. That policy is already in place. Why not make the states an equal partner, rather than subservient to the final approval by the government?

Senator WYDEN. Governor, I just want to make it clear, I am anxious to work with you. That, to me, is the central question. I cannot support something, at a time when the technology sector is so fragile, that would put in place a new taxing regime before we have been out on the floor of the U.S. Senate and debate it, and the fact is that this is an important question for the U.S. Senate. The Senate has voted twice on the question of whether to set aside that Supreme Court decision. More than 60 Senators on each occasion said no, so we are going to work with you, and it is an important process question.

The second question I want to ask real quickly is, could you tell us what provisions in the Internet Tax Freedom Act as written now are unfair?

The CHAIRMAN. Would you tell us briefly?

[Laughter.]

Governor GERINGER. I cannot quote you the section, Mr. Chairman, Senator, but it is the portion that describes the arbitrary or—and I cannot remember the terminology that is there, but it is the discriminatory taxes. It would appear to disallow any current state tax that is collected as being a new tax. That is unclear in the current act.

Senator WYDEN. We will work with you on that. We have always said that we are interested in technological neutrality, treat the offline world like you treat the online world. We will work with you.

My time is up, and I thank you, Mr. Chairman.

The CHAIRMAN. Any other questions?

STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Senator HUTCHISON. Mr. Chairman, thank you. I will be brief. I know that time is of the essence, but I do appreciate so much your holding this hearing, because I am very concerned about two issues.

I come from a state that has no state income tax. 40 percent of our state revenue comes from sales and use taxes. We do not want to tax access to the Internet, but we do want a fair and level playing field for the Main Street businesses that operate and contribute to our communities, and we do not want a huge deficit to form in our state revenues because there is an unlevel competition.

So I am signed on with Senator Dorgan and Senator Enzi to encourage states, and I have written to the National Governors Association and the National Council of State Legislatures today asking that they come up with a model law immediately. Let Congress look at it so that we would have the comfort that states who wished to create the level playing field would be able to do that on an expedited basis, and those states which do not would certainly not have to join the compact.

But I think we are coming to some agreements, and I hope that with your testimony and the next panel that we will be able to create a level playing field, give states some options where they need it, but not in any way keep from allowing the states to do what they need to do and certainly keep the strength of the Internet and what it has provided for consumers in our country.

Thank you.

The CHAIRMAN. Thank you, Senator Hutchison.

Senator EDWARDS. Senator Fitzgerald.

Senator DORGAN. Mr. Chairman, might I ask consent to put a letter in the record?

The CHAIRMAN. Without objection.

[The information referred to follows:]

Hon. JOHN MCCAIN,
Chairman,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Hon. ERNEST F. HOLLINGS,
Ranking Member,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Chairman McCain and Ranking Member Hollings:

We are writing to outline the importance of our legislation, the Internet Tax Moratorium and Equity Act (S. 512), and specific legislative provisions in the Internet Tax Freedom Act of 1998 that should be further discussed during the first session of the 107th Congress. We believe that it is absolutely imperative that Congress move quickly this year to consider this legislation and the difficult tax issues relating to Internet sales that it seeks to address.

First, most everyone who is familiar with this issue knows that the current expiration date for the moratorium on Internet access and discriminatory taxes is fast approaching. We believe the moratorium should be extended. That's why S. 512 would extend the current moratorium for an additional four years. Also, this legislation moves toward a solution to the growing web of tax compliance problems that faces virtually everyone who would do business across state lines—sellers and customers alike.

Despite some setbacks, Internet technology and commerce will continue to be a real growth engine for our economy. The past holiday season, retail sales over the Internet jumped 76 percent from the same period a year earlier. A recent University of Texas study estimated that $830 billion in revenues were generated by the Internet economy in 2000, up 58 percent from 1999 levels. Together, this information suggests that Internet sales are not going to be either temporary or insignificant, and neither are the compliance problems.

We believe that the approach embraced in our bill would help create a climate in which web-based firms and Main Street businesses can co-exist and compete on fair and even terms. Any new form of commerce presents a challenge to the rules and structures that have grown up around the old. The automobile required the reform of traffic-control rules designed for the horse-and-buggy era. And the Internet is no exception. The Internet has raised vexing questions about privacy and property rights. It has raised similarly vexing questions regarding the revenue systems of the states and localities of this nation. Clearly, the Internet does not fit neatly into these systems as they have evolved over the last two hundred years. This disconnect has created tensions between vital new businesses (Internet service providers and web-based businesses), state and local governments, and Main Street merchants, which is understandable and valid. Our job in Congress is to try to address the problem in a fair and constructive way.

The solution begins with a recognition of the problem. Collecting a sales tax in a face-to-face transaction on Main Street or at the mall is a relatively simple process. The seller collects the tax and remits it to the state or local government. But with remote sales—such as catalog and Internet sales—it's more difficult. States cannot require a seller to collect a sales tax unless the business has an actual location or sales people in the state. So most states, and many localities, have laws that require the local buyer to send an equivalent "use tax" to the state or local government when he or she did not pay taxes at the time of purchase.

The reality, of course, is that customers almost never do that, and in many cases are unaware of their obligation to pay a use tax. It would be a major inconvenience, and people are not accustomed to paying sales taxes in that way. So, despite the requirement in the law, most simply don't do it. This tax, which is already owed, is not paid. For years, state and local governments could accept this loss because catalog sales were a relatively minor portion of overall commerce. The rapid growth of Internet sales is changing all that.

Internet and catalog sellers correctly argue that collecting sales taxes would be a significant burden for them. Understandably, they contend that it would be difficult for them to have to comply with tax laws from thousands of different jurisdictions—46 states and thousands of local governments have sales taxes with different tax rates and all of the idiosyncrasies regarding what is taxable and what is nontaxable. However, there are some remote sellers who know they enjoy an advantage over Main Street businesses and simply do not want to lose it. They can sell a product without collecting the tax, whereas Main Street businesses must collect the local sales tax. Main Street businesses claim that is unfair, and they have a point, too.

There are three basic principles underlying the Internet Tax Moratorium and Equity Act. First, we believe that this new Internet technology will remain a real growth engine for our economy, and the solution must begin by putting the worries of web-based entrepreneurs to rest. They should not be concerned about new and discriminatory tax burdens, and they should not be singled out as cash cows. Congress should make this clear. That's why our bill would extend the existing moratorium, which is set to expire on October 21st, through December 31, 2005, That will help remove some of the anxiety about the approaching expiration date, while giving all stakeholders—state and local governments, Internet sellers, and the bricks and mortar retail community—time to work together to develop a real solution for the sales and use tax compliance problems now facing many businesses and their customers.

Second, state and local governments should be encouraged to simplify their sales tax systems as they apply to remote sellers. And third, once states have reduced the burden on sellers by simplifying their sales and use tax systems, then it is only fair that remote sellers do their part and collect any use tax that is owed, just as local merchants collect sales taxes. This simple step would free the consumer from the burden of having to report such taxes individually. It would level the playing field for local retailers and others that already collect and remit such taxes, and it would protect the ability of state and local governments to provide necessary services for their residents in the future.

Further, additional concerns have been raised by interested parties that the definition of Internet access and ambiguous provisions in the definition of discriminatory taxes in the Internet Tax Freedom Act as passed by Congress in 1998 may be used inappropriately by some retailers to avoid collection responsibilities in a manner never intended by Congress. Their concerns stem from the fear that as Internet and electronic commerce technologies continue to develop they may converge with other related communications technologies and media. Yet, these service providers could be subject to widely different tax regimes because of the intervention of the Internet Tax Freedom Act. As a consequence, the current definition of Internet access in the Act could have large, unintended consequences if the definition is not changed. Also, there is a concern that some sellers will try to inappropriately use ambiguous provisions in the definition of discriminatory taxes to avoid collecting sales taxes even though the seller uses Internet kiosks or Internet cash registers physically located in a state as a means of making sales. The attempts to use ambiguous language as a potential loophole will only exacerbate the inequity between retailers that collect the tax and those who don't.

In our judgment, it would be a serious mistake for Congress to adopt a lengthy extension of the current Internet tax moratorium without addressing these underlying problems. If we do not address the problems, then the growth of the Internet, which should be a benefit to Americans, will instead mean a major erosion of funds available to build and maintain schools and roads, finance police departments and garbage collection, and all the other services that citizens in this country want and need.

There is no question that left unchanged the current collection system will have a significant impact on the ability of states and local governments to fund their core responsibilities. States and local jurisdictions rely on sales taxes to fund a host of community services. Permanently exempting Internet sales from state and local taxation would lead to one of two bad outcomes: higher state and local taxes in other areas to compensate for a devastating loss of sales tax revenue, or a greater reliance on the Federal Government for even the most basic community services. The slowing economy has already reduced tax revenue in many states, and as many as 15 states that depend on sales and manufacturing taxes are facing spending cuts as high as 15 percent. Further, federal preemption in this area erodes the ability of state and local taxpayers to shape the policies that affect their lives.

Moreover, the competitive crisis facing local retailers is also growing more urgent. In testimony before the Commerce Committee in the last Congress, a representative from a large retailer testified that his company is incorporating a separate business to put the business on the Internet. It will do so in a manner that will enable them to avoid sales and use taxes. Even though the retailer has locations in every state and therefore would be required to collect such taxes on Internet sales, it believes that such avoidance is needed to compete with other large competitors that will be making those sales tax-free. This scenario could play out over and over again unless we act quickly and decisively. If we do not act, the large retailers will survive, the small Main Street businesses will continue to struggle, and there will be a massive loss of revenues to fund schools and other basic services.

It is important for Congress to begin the process of finding a long-term solution to the problem this year before the moratorium expires. We believe that our legislation strikes a proper balance between the interests of the Internet industry, state and local governments, local retailers and remote sellers. We look forward to working with you in an efficient and effective manner to achieve the best outcome for all involved parties.

Sincerely,

BYRON L. DORGAN,
U.S. Senator.
MICHAEL B. ENZI,
U.S. Senator.
BOB GRAHAM,
U.S. Senator.
GEORGE VOINOVICH,
U.S. Senator.
JOHN BREAUX,
U.S. Senator.

The CHAIRMAN. Well, Governor and Lieutenant Governor, obviously we have a very interesting issue here. I want to thank you. We have two major Internet issues facing the Congress and the American people. One is this issue, and the other is the issue of Internet privacy. We would also appreciate your input on the issue of Internet privacy as well, as we try to address that very important issue.

Governor.

Governor GERINGER. Just a brief comment, Mr. Chairman. I am the chairman of the Task Force on Technology and E-Governance. We have privacy at the top of our list. We would be pleased to work with you on that.

The CHAIRMAN. We will look forward to it, and we will invite you back to another hearing in order to be able to hear your views and communicate with you frequently.

Thank you very much. Thank you, Governor.

Governor GERINGER. Thank you.

The CHAIRMAN. And Lieutenant Governor Swift, we all hope that the ensuing weeks proceed very well for you.

Ms. SWIFT. Thank you.

The CHAIRMAN. We will be watching the media.

[Laughter.]

Ms. SWIFT. Hopefully not too much of it.

The CHAIRMAN. And congratulations.

Ms. SWIFT. Thank you.

The CHAIRMAN. Our next panel is Mr. Frank Julian, the operating vice president and tax counsel of Federated Department Stores, Incorporated, Mr. Peter Lowy, who is the chief executive officer, Westfield America, Mr. Robert Comfort, the vice president of tax and tax policy of Amazon.com, Ms. Elizabeth Harchenko, who is the Director of the Oregon Department of Revenue, Mr. Jeff Dircksen, director of congressional analysis of the National Taxpayers Union.

Senator DORGAN. Mr. Chairman, while the panel is forming, might I ask that you send a letter to all the stakeholders. We have gotten a lot of letters back from them on this issue. I wonder if I could ask the Senator if you felt it appropriate that we include those letters in the Committee hearing record for today.

The CHAIRMAN. Without objection. I think it would be very beneficial. Mr. Julian.

STATEMENT OF FRANK G. JULIAN, OPERATING VICE PRESIDENT AND TAX COUNSEL, FEDERATED DEPARTMENT STORES, INC.

Mr. JULIAN. Good morning, Mr. Chairman. My name is Frank Julian, and I am operating vice president of the Federated Department Stores.

The CHAIRMAN. Before you begin, Mr. Julian, I am told that we have a vote in about 5 minutes. We would like to get through a couple of the opening statements. We may have to take a break and then the Members will return for the rest of the hearing, and I am told that there are three votes, so there may be a lengthy break here and not a short one.

Thank you, Mr. Julian.

Mr. JULIAN. Yes, sir. I will proceed and I am here all day, so I am at your disposal.

My name is Frank Julian. I am operating vice president of Federated Department Stores in Cincinnati. Federated operates 400 department stores in 33 states under the names of Macy's, Bloomingdale's, the Bon Marche, and others, and a significant direct consumer business with its Fingerhut, Bloomingdale's by Mail, and Macy's.com subsidiaries. I am here today on behalf of the Internet Tax Fairness Coalition, an alliance of retail, technology, and communications companies.

As the Supreme Court has recognized, the myriad of complex state and local sales tax systems in existence today places intolerable burdens on interstate commerce. Federated collects and remits over $1 billion per year in sales tax for the states where we do business. I can assure you that the burdens of collecting this tax are very real. Sales taxes must be simplified if they are to survive. S. 288, introduced by Senators Wyden and Leahy, establishes a solid framework for the needed simplification.

As noted in my written testimony, the ITFC developed a list of 19 essential simplification parameters, virtually all of which are included in the Wyden-Leahy bill. Of these 19 principles, however, two that are among the most important to business are the two that state and local governments have opposed the most. Only one sales and use tax rate and base per state, and bright line nexus standards for business activity taxes.

A third important principle, uniform definitions, also seems to be a difficult pill for the state and local governments to swallow. There are over 7,600 sales tax jurisdictions in the U.S. There are 1,296 in the State of Texas alone. Is it fair to require a direct marketer with residence only in Oregon to know which combination of these 1,296 rates applies to every item of merchandise it sends to a customer in Texas, and then to collect and remit the proper amount of tax to the Texas authorities, when that same direct marketer is not required to collect any sales tax on behalf of its home State of Oregon?

There should only be one tax base per state. Allowing local jurisdictions to separately determine the taxability of items shipped to their residents adds immeasurable complexity. If the State of Colo-

rado exempts widgets from sales tax, the city of Denver should not be allowed to impose a sales or use tax on that same widget. Businesses should not be required to pay a business activity tax to jurisdictions in which they are not physically present, and thus not receiving significant tangible benefits.

If Congress is going to exercise its Commerce Clause authority to require remote sellers to collect sales tax, then Congress should at the same time protect those sellers from being subjected to business activity taxes in those foreign states. We urge Congress to enact a bright line nexus standard that requires physical presence in a state before a company can be subjected to a business activity tax.

The Commerce Clause vests in Congress the authority to protect interstate commerce. This is a serious responsibility that Congress should not abdicate to the states. For this reason, Congress must establish the parameters of simplification and uniformity and evaluate the states' efforts before granting them extended tax collection authority. The states have begun simplification efforts through the streamlined sales tax project. In December, the SSTP released a model act that it encouraged its member states to adopt. The SSTP model includes some of the important simplification standards included in S. 288.

I applaud the states' efforts. In the final analysis, however, their proposal falls into the category of simplification light. In January, the NCSL created its own version of the model. If the SSTP's model is simplification light, the NCSL's version is simplification ultra light. As a result, there are now competing simplification bills pending in several state legislatures. As of March 1, eight states were considering the SSTP's model, eight were considering the NCSL version, and two states created their own proposal. For a topic in which the goal is tax uniformity, this smacks of chaos, and clearly underscores the need for congressional oversight.

The ITFC strongly supports Senators Wyden and Leahy in their efforts to extend the moratorium and to permanently ban sales tax on Internet access charges. Elimination of sales taxes on Internet access will help to close the so-called digital divide.

Many of my fellow retailers have argued that they cannot compete against the dot coms, and that if e-commerce is not saddled with complex tax collection burdens, it could spell the end of traditional brick-and-mortar retail. Some of the most passionate testimony in this regard was delivered to this very Committee in its hearings last April.

Although I have a lot of respect and admiration for my fellow retailers, this is one instance where they were wrong. The sky is not falling on brick-and-mortar retail. Many of the once-feared dot coms have become dot bombs. Our weakening economy is having a profound negative impact on the fledgling e-commerce sector. Allowing state and local governments to unleash economic anarchy in the current environment could have long-term devastating effects on the economy, business, and employment.

It is critical for Congress to protect this vital segment of our economy from potentially failed tax burdens by extending the moratorium and by demanding that the states significantly simplify their sales tax systems. Only after the states prove that they have

met the high bar for simplification established by Congress should they be granted the broad tax collection powers they now seek.

Mr. Chairman, I thank you very much for the opportunity to testify and, as I said, I am here all day to answer your questions.

[The prepared statement of Mr. Julian follows:]

PREPARED STATEMENT OF FRANK G. JULIAN, OPERATING VICE PRESIDENT AND TAX COUNSEL, FEDERATED DEPARTMENT STORES, INC.

Introduction

Good Morning. My name is Frank Julian. I am Operating Vice President and Tax Counsel for Federated Department Stores, Inc. in Cincinnati, Ohio. Federated is one of the nation's leading department store retailers. We operate more than 400 department stores in 33 states under the names of Bloomingdale's, Macy's, Rich's, The Bon Marché and others. Federated also has a significant direct mail catalog and electronic commerce business with its Fingerhut, Bloomingdale's By Mail, bloomingdales.com and Macys.com subsidiaries.

Although Bloomingdale's By Mail, bloomingdales.com and Macys.com are each separate subsidiaries, they collect sales tax on sales into any state where Bloomingdale's and Macy's, respectively, have department stores.

I am here today on behalf of the Internet Tax Fairness Coalition ("ITFC"). The ITFC is an alliance of business, consumer, retail, technology and communications companies and industry groups that promote clear and simple tax rules for the borderless marketplace. I also chair the Tax Committee of The Direct Marketing Association. The DMA is one of the members of the ITFC.

Summary of Position

The myriad of confusing and inconsistent state and local sales tax systems in existence today places tremendous burdens interstate commerce and the economy. The ITFC believes that S. 288, introduced by Senators Wyden and Leahy, represents a significant first step toward unraveling this confusion. The ITFC supports the following objectives for reducing the tax burdens imposed on interstate commerce that thwart the development of a borderless marketplace:

- Establish simple and uniform sales and use tax rules that reduce compliance burdens for all taxpayers, and provide a reasonable collection allowance to compensate all sellers for the burdens they must incur in collecting the tax.
- Enact nexus standards for business activity taxes that eliminate uncertainty and the potential for double taxation.
- Promote availability of the Internet to all by prohibiting taxes on access fees.
- Prevent multiple and discriminatory taxation by extending the application of established nexus rules to remote commerce.

The ITFC supports neutral tax treatment of electronic commerce; it does not support the creation of a "tax-free" zone for electronic commerce. ITFC believes it is also critical to enact appropriate bright-line nexus standards for business activity tax nexus purposes in conjunction with an extension of the moratorium and development of uniform and clear rules for the taxation of all commerce.

Moreover, the ITFC believes that Congress should not pass any legislation that would give states "prior approval" to a simplification compact before the details of the simplification are known and evaluated.

Discussion

The burdens that the current sales tax systems place on interstate commerce have been well documented. The Supreme Court recognized these intolerable burdens on interstate commerce in its 1967 decision in *National Bellas Hess v. Department of Revenue,* and again in 1992 in *Quill Corp. v. North Dakota.* In *National Bellas Hess,* the Court found that the "many variations in rates of tax, in allowable exemptions, and in administrative and record keeping requirements could entangle . . . interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government.'"

The hearings conducted by the Advisory Commission on Electronic Commerce ("ACEC") raised an awareness, in an unprecedented manner, of the level of complexity and burdens imposed by the current sales tax systems. By the time the ACEC completed its work, there was near universal agreement that the disparate

state sales tax systems in place today must be substantially simplified and unified—as they apply to all sellers—if they are to survive.

Federated collects and remits more than $1 billion per year in sales tax for the state and local governments where we do business. We incur substantial costs in collecting and remitting these taxes, and in administering the many audits that follow.

While this is a steep burden for us, it is not one that will put us out of business. The same may not be said, however, for some smaller companies or those less financially stable. In those cases, such a burden could put them out of business.

Substantial simplification of the sales tax systems will make it much easier for the states to administer and enforce the tax, and will make it much easier for sellers to comply with tax collection requirements.

Guidelines for Simplification and Uniformity

ITFC believes that simplification and uniformity must be at a level that eliminates undue and discriminatory burdens on interstate commerce. The ITFC has spent considerable time developing draft federal legislation that it believes would encourage the states to simplify and unify their sales and use tax systems so as to eliminate undue burdens on interstate commerce. Some of the specific items in that draft that we believe are crucial to achieving such a goal include:

1. A centralized, one-stop, multi-state registration system for sellers.
2. Uniform definitions for goods or services that could be included in the tax base.
3. Uniform and simple rules for attributing transactions to particular taxing jurisdictions.
4. Uniform rules for the designation and identification of purchasers and transactions exempt from sales and use taxes, including a database of all exempt entities and a rule ensuring that reliance on such a database shall immunize sellers from liability for both under-collection and over-collection of tax.
5. Uniform procedures for the certification of software upon which sellers may rely to determine applicable sales and use tax rates and taxability, and immunity from liability for under-collection and over-collection of tax for sellers who rely on such software.
6. Uniform bad debt rules.
7. Uniform tax returns, remittance forms, and filing and remittance dates.
8. Uniform electronic filing and remittance methods.
9. State administration of all sales and use taxes in such state.
10. Uniform audit procedures, including a provision giving a seller the option to be subject to no more than a single audit per year using those procedures; provided that if the seller does not comply with the procedures to elect a single audit, any state can conduct an audit using those procedures. If elected, however, the single audit binds other states.
11. Reasonable compensation for tax collection by all sellers.
12. Exemption from use tax collection requirements for remote sellers falling below a specified de minimis threshold of less than $5,000,000 in prior-year gross annual sales, or less than $100,000 in any state during that prior-year. This exemption would not, however, operate to exempt a seller with less than $5,000,000 in prior-year gross annual sales for any obligation to collect and remit sales or use taxes imposed by the state in which that seller is located.
13. Appropriate protections for consumer privacy.
14. A single, uniform statewide sales and use tax rate and base on all transactions on which a sales or use tax is imposed.
15. For those states that impose a sales or use tax on digital products, an origin state default rule, for transactions where the location of the customer is not disclosed during the transaction, that permits the seller to rely upon information given by the customer during the transaction.
16. Appropriate bright-line nexus standards for business activity tax nexus purposes that limit business activity tax nexus to sellers that lease or own substantial tangible personal property, or have a number of employees or actual agents, in the taxing jurisdiction for more than 30 days during the taxable year.

17. Uniform dates, not to exceed two (2) in any calendar year, on which changes to sales and use tax rates may become effective, and a requirement that a state give at least 120 days' notice before any change in its sales or use tax rate becomes effective.
18. Allows the Untied States Court of Federal Claims to resolve conflicts that arise with regard to interpretation of similar sales and use tax provisions of the different states.
19. Such other features that will achieve a simplified and uniform sales and use tax system.

The ITFC is very pleased that virtually all of these simplification points are included in the Wyden-Leahy Bill (S. 288).

Of these 19 principles of simplification, two that are among the most important to the business community are the two that state and local governments have opposed the most: One sales and use tax rate and base per state, and nexus standards for business activity taxes. A third very important principle, uniform definitions for goods and services, also seems to be a very difficult pill for state and local governments to swallow.

One Rate and One Base Per State

There are more than 7,600 different sales tax jurisdictions in the United States today, each with its own tax rate, and many with their own tax base and rules and regulations. I should also note that in 1967, when the Supreme Court ruled in *National Bellas Hess* that it was an unconstitutional burden on interstate commerce to require sales tax collection in states where the seller did not have a physical presence, there were "only" 2,300 jurisdictions to deal with. This proliferation of taxing jurisdictions is symbolic of the ever-increasing complexity of the existing sales and use tax systems.

In the State of Texas alone there are 1,109 separate city tax rates and 119 county tax rates. In addition, there are 67 "special" tax jurisdictions, ranging from crime control districts to library districts; 27 of these special jurisdictions have geographical boundaries that do not correspond to any city or county boundary. When combined with the state rate, this results in 1,296 different taxing jurisdictions in the State of Texas.[1]

Is it fair to require a direct marketer with presence only in Oregon to know which combination of these 1,296 rates applies to every item of merchandise it sends to a customer in Texas, and then to collect and remit the proper amount of tax to the Texas authorities, when that same direct marketer is not required to collect any sales tax on behalf of its home State of Oregon?[2] Add to this the fact that there is a zero margin of error for the seller: If the seller under-collects the tax from its customer, the seller must pay the tax out of its pocket and is subject to interest and penalties by the taxing authorities. If the seller over-collects the tax, it is subject to class action law suits from its customers, as well as consumer fraud actions from state attorneys general. This puts the seller in an untenable position.

The states will argue that this problem can be fixed by using software that calculates the applicable sales tax rate by ZIP Code. We submit that this is not an acceptable solution. There are hundreds of five digit ZIP Codes across the country in which there are multiple taxing jurisdictions; moreover, there are scores of nine digit ZIP Codes in which there is more than one taxing jurisdiction. Thus, even if software existed that could provide an accurate nine digit ZIP Code for every order placed with a remote seller, the seller still might not be able to accurately collect the proper amount of sales tax.

It should also be noted that none of the proposed "software solutions" will alleviate the problems faced by sellers whose customers pay by check.

The states have suggested alternatives that would use the Census Bureau's "FIPS" Code, or would create a unique 10-character coding scheme for each separate taxing jurisdiction.[3] None of this very sophisticated technology exists today. However, under the best of circumstances, forcing remote sellers to collect tax for 7,600 different taxing jurisdictions will saddle interstate commerce with substantial burdens. The ITFC believes that Congress should do everything in its power to eliminate undue burdens on this vital segment of America's economy.

---

[1] Although Texas was used for illustration purposes here, there are several states in which the burdens imposed by the local taxing jurisdictions are significantly greater than in Texas.

[2] Oregon is one of five states in the country that does not have a sales tax.

[3] For example, a remote seller sending merchandise to a customer who lives in the Dripping Springs Community Library District in Texas would need to know that the customer lives in Tax Jurisdiction Number 48DLI21424.

In 1999, the National Tax Association ("NTA") conducted a Communications and Electronic Commerce Tax Project, the precursor to the ACEC, which included all the major state and local government organizations and electronic commerce industry trade associations. The only tax reform measure to receive unanimous agreement from the Project's participants was "There should be one rate per state which would apply to all commerce involving goods or services that are taxable in that state."

Some have recommended that there be one rate per state for remote commerce only, and that in-state businesses continue to collect all of the local jurisdictions' taxes. The NTA Project participants considered, and rejected, this proposal. The ITFC agrees that such a proposal is ill-advised for the following reasons:

The ITFC strongly advocates "channel neutrality" in the treatment of commerce. To achieve channel neutrality, and to avoid favoring one business medium over another, the sales tax rate applicable to a particular item must be the same regardless of whether the purchase was made from an Internet vendor or from an in-state brick and mortar store.

The ITFC also strongly believes that there should only be one tax base per state. Allowing local jurisdictions within a state to separately determine the taxability of items sold in, or shipped to, their jurisdictions adds immeasurable confusion and complexity. If the State of Colorado exempts widgets from sales tax, the City of Denver should not be allowed to impose a sales or use tax on that same widget.

Congress has a duty under the Commerce Clause to facilitate the flow of commerce among the states. Incorporated in this duty is Congress' responsibility to limit the imposition of barriers to the free flow of commerce. Insisting that there be no more than one tax rate and one tax base per state, for all types of commerce, before requiring remote sellers to collect sales tax in states where they lack a physical presence is wholly consistent with Congress' duty under the Commerce Clause.

Business Activity Tax Nexus

Determinations of the jurisdiction to impose a tax should be governed by one fundamental principle: a government has the right to impose economic and administrative burdens only on taxpayers that receive meaningful benefits or protections from that government. In the context of business activity taxes,[4] this guiding principle means that businesses that are not physically present in a jurisdiction, and are therefore not receiving significant tangible benefits or protections from the jurisdiction, should not be required to pay a business activity tax to that jurisdiction.

In its Commerce Clause jurisprudence, the Supreme Court has ruled that a business must have "substantial nexus" in a state before a state can constitutionally subject that business to its taxing power. For purposes of requiring a business to collect a state's sales and use tax, the Supreme Court has ruled that substantial nexus requires "physical presence" in the state.

Although the Supreme Court has not had occasion to address the requisite level of nexus for a state to impose a business activity tax, several state courts have addressed the issue. Many of these state courts have affirmed that the nexus standard for business activity taxes can be no less than the "physical presence" standard for collection of sales and use taxes. For example, one state court has held that the retention of credit cards by an out-of-state credit card issuer was insufficient to give the issuer physical presence for state income tax purposes. Unfortunately, courts in some states have reached the opposite conclusion.

Litigation and uncertainty in this area continue to proliferate. If remote sellers are required to begin collecting and remitting sales tax in every state, then those states will have a road map by which to aggressively pursue these same sellers for business activity taxes. Many small and medium-sized sellers lack the resources to challenge spurious claims for state income taxes.

If Congress is going to exercise its authority under the Commerce Clause to require remote sellers to collect sales tax in states where they have no physical presence, then Congress should, at the same time, protect those sellers from being subjected to business activity taxes in those same states. The manner in which to provide this protection to business, and to put and end to the litigation and uncertainty, is for Congress to enact a bright line nexus standard that requires physical presence in a state before a company can be subjected to a state's business activity tax.

---

[4] "Business activity tax" refers to tax imposed directly on businesses and not generally passed directly on to consumers. These include corporate income taxes, franchise taxes, single business taxes, capital stock taxes, net worth taxes, gross receipts taxes, use taxes and business and occupational taxes.

All Sellers Should Receive a Reasonable Collection Allowance

We believe that all sellers should receive a reasonable collection allowance to compensate them for the costs they incur in collecting sales tax.

Obviously, the more simplification measures that are enacted, the more the collection costs incurred by sellers will be reduced, thus reducing the amount of collection allowance that will be required.

Studies have shown that the average cost to collect sales tax exceeds 3 percent of the amount of tax collected. Of the 45 states with a sales tax, however, only seven provide for an uncapped collection allowance of greater than 1 percent. For a company like Federated, this amounts to tens of millions of dollars a year in expenses we incur to serve as a tax collector for the states. This number will clearly grow if we are forced to collect tax on behalf of every state in the country. For smaller businesses, and for those with tight budgets, the unreimbursed cost of collecting sales tax is yet one more large straw on the camel's back. In today's economic times, it could be the fatal straw for many companies.

Several members of the business community have approached representatives from state and local government about jointly commissioning a new, independent study to determine the cost of collecting sales tax. We are hopeful that the public sector will join us so that we may quickly get this study underway. Such a study should prove very helpful to Congress in determining the amount of collection allowance to which sellers are entitled.

Congress Must Provide the Framework for Simplification

The Commerce Clause vests in Congress the authority to regulate interstate commerce, and to guard against interference with interstate commerce. This is a serious responsibility that Congress should not abdicate to the states.

For this reason, ITFC believes it is incumbent upon Congress to (1) establish the parameters of simplification and uniformity that must be enacted before states are given the right to require remote sellers to collect their tax, and (2) review and evaluate the measures which the states enact—before granting them extended tax collection authority—to ensure that the states actually have met the Congressionally mandated standards.

The states have begun efforts to simplify their sales tax systems. Beginning in March, 2000, an ever-growing number of state tax administrators has been working on the Streamlined Sales Tax Project ("SSTP"). The SSTP was formed to develop measures to design, test and implement a sales and use tax system that radically simplifies sales and use taxes. The ultimate goal of the Project is to develop a simplified sales tax under which remote sellers without a presence in a state will voluntarily agree to collect sales tax on their sales into that state. In December, 2000, the SSTP released a model act and model agreement that it encouraged its member states to adopt.

The various state tax administrators who have been involved in the Project have worked tirelessly to accomplish their goal. They have included in their work product some of the important tax simplification standards that are included in S. 288. Moreover, the SSTP proposals include many elements of tax simplification that will be beneficial to brick and mortar sellers in collecting the tax in the states where they do business. On behalf of the ITFC, I applaud them for their efforts.

Before Congress authorizes the states to require remote sellers to collect tax in states where they lack a physical presence, the sales and use tax laws must be substantially simplified and made more uniform. The sales tax system developed by the SSTP, however, falls into the category of "simplification light." While it alleviates some burdens on all sellers, it would nonetheless result in undue burdens on interstate commerce if all sellers were required to collect in every state under this system.

Some of the particular shortfalls of the SSTP proposal include: (1) failure to require only one tax rate per state,[5] (2) failure to call for business activity tax nexus standards, and (3) failure to provide simple definitions for items like "clothing."

In January, 2001, the National Conference of State Legislatures ("NCSL") met to discuss the legislation proposed by the SSTP. The NCSL was unhappy with several provisions in the SSTP's final proposals, so it made several significant modifications and created its own version of a model act and agreement. In particular, the NCSL version does not call for one tax base per state, and eliminated virtually all of the common definitions included in the SSTP model.

---

[5] The SSTP calls for one tax base per state beginning in 2006.

If the SSTP's proposal represented a first step toward the kind of simplification the business community believes could lead to a reduction in compliance burdens, the NCSL's proposal represents a step backwards.

The stated purpose for the NCSL's actions was to be able to have model legislation that would be likely to pass in many state legislatures this year. In our view, the goal should not be to propose legislation that will pass just for the sake of passing. The goal must be to achieve simplification and uniformity that will substantially reduce, not merely maintain, the current undue burdens on interstate commerce.

The result is that there are now competing versions of sales tax simplification bills pending in several state legislatures. According to the SSTP's website, as of March 1, 2001, eight[6] states were considering the SSTP's model legislation, eight states were considering the NCSL version, and two states were considering separate modified legislation. (A printout of this portion of the SSTP's website is attached as Exhibit A.)

For a topic in which the goal is tax uniformity, this smacks of chaos, and in our opinion clearly underscores the need for Congressional oversight of this process.

Congress Should Extend the Moratorium and Ban Taxes on Internet Access

As Senators Wyden and Leahy have proposed in S. 288, the moratorium contained in the Internet Tax Freedom Act on multiple and discriminatory taxes on electronic commerce should be extended, and taxes on Internet access should be permanently banned.

The purposes of the moratorium were to (1) ensure that the rules that apply to other forms of remote commerce also applied to electronic commerce, and (2) allow time for the ACEC to study ways to simplify the current complex state sales and use tax systems. The Internet Tax Freedom Act has never prevented the states from collecting sales and use tax otherwise due on goods and services purchased over the Internet.

Allowing the moratorium to expire would send a signal to the states that it is now permissible for them to treat electronic commerce differently from transactions using other channels. Extending the moratorium on discriminatory taxes thus is essential to ensuring neutral tax treatment for electronic commerce going forward. The fact that state and local government groups oppose the moratorium suggests that they are poised to assert that the nexus rules that apply to mail order transactions do not apply to Internet transactions. If this is not the position of the state and local governments, then they have nothing to fear from an extension of the moratorium.

The ITFC also supports Senators Wyden and Leahy in their efforts to permanently ban sales tax on Internet access charges. A majority of the ACEC recommended a similar ban.

The Internet has been a tremendous growth engine for our economy. Access to this very important medium should not be burdened with taxes. Moreover, imposition of sales taxes on Internet access will have a deterrent effect on the ability of lower income families to use the Internet. Elimination of these taxes will help to close the so-called digital divide.

The Sky Is Not Falling

During the past three years, many of my fellow retailers, as well as representatives from the shopping center industry, state and local government and others, predicted that there would be an explosive growth of electronic commerce, and that it would be detrimental to their interests. Remarkably, they argued to the ACEC and to Congress that if electronic commerce were not saddled with the complex tax collection burdens, it could spell the end of traditional brick and mortar retail as we know it today. Some of the most passionate testimony in this regard was delivered to this very Committee in its hearing last April.

Although I have a lot of respect and admiration for my fellow retailers, this is one instance where they were wrong: The sky is not falling on brick and mortar retailers. Many of the once feared "dot-com's" have become "dot-bombs." The demise of E-Toys is just one example of many recent failures in the electronic commerce world. Our weakening economy is having a profound negative impact on the fledgling electronic commerce sector.

Allowing state and local governments to unleash economic anarchy in the current environment could have long term, devastating effects on the economy, business and employment. We believe it is critical for Congress to protect this vital segment of our economy from potentially fatal tax burdens by extending the moratorium

[6] This includes Wyoming, which enacted the SSTP version.

against discriminatory taxes, and by demanding that the states significantly simplify their sales tax systems before being allowed to require remote sellers to collect their tax.

Conclusion

The labyrinth of sales and use tax systems in existence today is entirely too complex. State and local governments should not be permitted to export their burdensome tax collection obligations on remote sellers that do not have a physical presence in the state. The states should only be granted the authority to require remote sellers to collect their sales and use tax in a manner that does not interfere with, or place undue or discriminatory burdens on, interstate commerce.

To achieve this result, Congress must establish the parameters under which the state sales and use tax systems should be substantially simplified and made more uniform. Congress must then evaluate the states' efforts to be sure that the requisite level of simplification and uniformity has been attained. Only then should Congress grant the states the broad tax collection powers they now seek.

In addition, Congress should act now to extend the moratorium and to permanently ban Internet access charges.

I sincerely appreciate the opportunity to testify before you today, and I will be happy to answer any questions.

EXHIBIT A

STATUS OF STATE EFFORTS ON STREAMLINED SALES TAX PROJECT
(as of 03/01/01)

Indicates SSTP Version of Legislation; Indicates NCSL Version of Legislation; Indicates Modified Act; Indicates Legislative Enactment; Indicates No Sales Tax State

STATE	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATI
Alabama	HB 472 and SB 321 (SSTP Act only) introduced on 02/19/01 by Rep. Lindsey and Sen. Sanders.	Both bills have been referred to the tax-writing committees. No hearings have been scheduled as legislature is currently in Special Session.		
Alaska				
Arizona				
Arkansas	HB 2170 (SSTP Act only) introduced on 02/27/01 by Rep. Hunt and Sen. Hill	Referred to the House and Senate tax-writing committees; hearings expected in the House soon.	Mary Cameron 501-682-7030	
California				
Colorado				
Connecticut				
[illegible] NO SALES TAX				
Florida				
Georgia				
Hawaii				
Idaho				
Illinois	SB164—(NCSL Act and Agreement) introduced by Sen. Rauschenberger			
Indiana	SB 269 (NCSL Act only) introduced on 01/10/01 by Sen. Borst	Senate Finance Committee held a hearing on SB 269 on 02/15/01. Committee voted to approve legislation.	Jim Turner 317-232-1862	
Iowa		Internal committee formed to draft Agreement; deadline for completion 03/01/01.	Carl Castelda 515-281-5990	Rev. Dept. officials have held a number of meetings with stakeholder groups, i.e., state retail federation, taxpayers association, local government groups; task force formed by Iowa Taxpayers Assn. to study proposal.
Kansas	SB 252 (Modified Act only) introduced upon recommendation of the Revenue Department and SSTP Oversight Committee.	SB 252 approved on February 14, 2001 by the full Senate; sent to the House Tax Committee for consideration.	Richard Cram	

STATE	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
Kentucky	HR 367 (SSTP Act) introduced on 02/20/01 by Rep. Moberly.	HB 367 approved on 03/01/01. Legislation sent to Senate for consideration week of 03/05/01.	Charlotte Quarles 502-564-6843	
Louisiana				
Maine				
Maryland	HB 1390 (NCSL Act only) introduced on 02/23/01.			
Massachusetts	H1523 (SSTP Act only) introduced on 01/03/01 by Rep. Travis	Referred to the Committee on Taxation; no hearings scheduled		
Michigan			Nancy Taylor 517-241-2734	Rev. Dept. officials feel legislators still need more education on issue; stakeholder meetings have been held with state retailers.
Minnesota	Will be introduced week of 02/26/01	Fiscal note being completed; Gov. referenced effort in state of the state address	Jenny Engh 651-226-9640	Rev. Dept. will be using media and industry focus groups to publicize efforts; have prepared talking points that will be made available to other states.
Mississippi				
Missouri	HB 803 (NCSL Act) introduced on 02/15/01 by Reps. Bray and Kennedy			
Montana	NO SALES TAX			
Nebraska	LB172 (SSTP Act only) introduced on 01/19/01 by the Revenue Committee.	Revenue Committee hearing on 01/19/01; legislative strategy is to pass the Act in '01 and address Agreement in '02.	Mary Jane Egr 402-471-5604	LB172 made two changes to the Act—gives the Governor authority to enter into Agreement and requires ratification of Agreement by the Legislature before state can participate.
Nevada	Will be introduced in 2001 (session starts 02/05/01).	Fiscal note being developed; probable sponsor is Assemblyman David Goldwater (D)	Woody Thorne 775-687-5774	The agreement will fall under the jurisdiction of the State's referendum law. Any changes to definitions, exemptions, etc. will require approval of the voters before taking effect. Thus, a major voter education effort will be required.
New Hampshire	NO SALES TAX			
New Jersey				
New Mexico				
New York				
North Carolina	SB 144 (SSTP Act and Agreement) introduced on 02/14/01 by Sen. Kerr.	Legislative proposal approved by Revenue Laws Study Committee on 01/16/01.	Sabra Faires 919-715-0237	Rev. Dept. holding meetings with stakeholder groups to provide education and gain support.
North Dakota	SB 2455 (NCSL Act) introduced on 02/08/01 by Sen. Cook and Sen. Nething	Passed by Senate Finance Committee on 02/20/01.	Gary Anderson 701-328-3471 Myles Vosberg 701-328-3011	

STATE	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
Ohio		Recommendation on whether to proceed this year must be submitted to Governor by 03/01/01.	Fred Church 614-466-0684	
Oklahoma	SB 703 (NCSL Act) introduced by Sen. Monson	Senate Finance Committee hearing on SB 703 scheduled for 02/20/01.		
[illegible] NO SALES TAX				
Pennsylvania				
Rhode Island		03/01/01—Governor issued recommendation to legislature that it should consider the SSTP Act for passage this year.		
South Carolina		Legislation is being drafted and discussed, but introduction date not determined	Meredith Cleland	
South Dakota		Governor forms Task Force to study impact on municipalities; report due in Dec. 2001.		
Tennessee	HB 1459 (NCSL Act) introduced on 02/14/01 by Rep. Kisber; SB 1722 (NCSL Act) introduced on 02/14/01 by Sen. Cooper.	Both pieces of legislation referred to Finance, Ways and Means Committees.	Jack Kopald 615-741-5884	
Texas	HB 1845 (NCSL Act) introduced on 02/21/01 by Rep. Oliveira	Legislation referred to Ways and Means Committee.		Rev. Dept. officials holding ongoing meetings with stakeholder groups to gain support.
Utah	SB 74 (modified Act) introduced by Sen. Hillyard.	SB 74 approved by Senate on 02/22/01; approved by House on 02/28/01; awaiting Governor's signature.	Bruce Johnson 801-297-3901	
Vermont	H457 (SSTP Act only) introduced by Rep. Keenan on 03/01/01.	Legislation referred to Ways and Means Committee.	George Phillips 802-828-2532	
Virginia				
Washington				
West Virginia				
Wisconsin	Legislation being drafted and expected to be considered during Spring legislative session.	Second hearing on SSTP held on 02/08/01 before the Joint Committee on Information Policy.	Diane Hardt 608-266-6798	Rev. Dept. continuing meetings with stakeholders; Rev. Dept. has put together talking points and information for insertion in business community newsletters—effort well received.
Wyoming	HB259 (SSTP Act and Agreement) introduced on 01/23/01 by Rep. Hines and Sen. Peck	HR 259 signed into law by Gov. Geringer on 03/01/01; Act will have immediate effective date; conforming amendments in Agreement have an effective date of July 1, 2002.	Johnnie Burton/Dan Noble 307-777-5287	

The CHAIRMAN. Thank you very much.

Mr. Lowy, I think we have time for your statement, and then we will probably have to take a break here.

STATEMENT OF PETER LOWY, CEO, WESTFIELD AMERICA; FOUNDING CHAIRMAN, E–FAIRNESS COALITION

Mr. LOWY. Thank you, Mr. Chairman. Good morning, Mr. Chairman, and distinguished Members of the Committee. First of all, I thank you for inviting me here this morning. I am the CEO of Westfield America, and am also the Founding Chairman of the e-Fairness Coalition, which represents the retail and real estate industries on this issue.

The CHAIRMAN. I retract. The vote has not been called yet, so we will probably be able to continue. Go ahead, Mr. Lowy. I am sorry.

Mr. LOWY. That is Okay.

The e-Fairness Coalition advocates a level playing field for sales and use tax collection for all retailers. We also support the continued growth of the Internet, and firmly oppose any form of discriminatory taxes and taxes on Internet access. The equitable collection of sales tax needs to be addressed concurrently with an extension of the current moratorium.

Congress must take action to level the retail playing field for three reasons: (1) the current sales tax system is broken. It simply does not work in the clicks and bricks environment; (2) equity or fairness, and (3) states rights, that is, the right of states to set their own tax policy.

The most urgent issue facing the Senate is the viability of the current consumption tax system. No longer are we looking at catalogue sellers who own a small percentage of the marketplace. We are discussing the ability of states to maintain their revenues and to provide a level of services needed within the current system.

The current sales tax system does not work in today's business environment. Due to market realities, brick-and-mortar retailers are forced to respond to their online tax-free competitors by setting up their own online stores as separate subsidies. A number of retailers, including K Mart, The Gap, Barnes & Noble, are installing systems in their stores connected to the Internet and their Internet retailing sites. Under this structure, companies then avoid physical nexus.

For instance, K Mart's online store, Bluelight.com, only collects sales taxes in California and Ohio. These are states where they have warehouses or headquarters. As long as this system is in place, more and more retailers will do the same.

As Internet kiosks are placed into physical stores, a customer can enter the store, sample or try on the merchandise, have the sales person order the merchandise over the Internet, have it delivered to the consumer, and avoid charging and collecting the sales tax.

The lack of clarity in the current law, especially with regard to returns, is preventing the natural convergence of these two systems. Convergence benefits business, consumers, and economic growth. Most of the country's largest retailers, who, in order to compete in the Internet economy, are forming these subsidiaries, would rather not be forced to do so. In fact, many are members of

the e-Fairness Coalition, and strongly advocate a level playing field.

The question is, where will states go to make up for the loss of revenue due to the advent of the dot com subsidiary? The issue of equity or fairness is not a question of whether there should be a consumption tax on goods and services but, rather, if a state chooses to have a consumption tax, should it be implemented equally? There is no logical argument that supports taxing the same retail transaction differently, depending on the delivery system. The marketplace should determine sales decisions, not discriminatory tax policies. The states, not the Federal Government, should have the right to impose or not impose consumption taxes as they see fit.

The reality is that education and other essential services are funded largely by the states, especially through sales taxes. Passing extension of the moratorium without taking steps toward a comprehensive solution would send a clear signal that Congress is willing to ignore a major national inequity in order to provide some businesses with preferential tax treatment. This could halt the substantial progress that states have made in simplifying and unifying their sales tax systems, and may force states to consider raising property or income taxes to make up for the revenues lost to remote sales.

I firmly believe that Congress should allow states to require all remote sellers to collect sales taxes on deliveries in that state, provided they dramatically simplify the sales tax system. As Amazon agreed in their letter to the Commerce Committee, once states simplify, thereby lifting administrative burdens off retailers, there is no reason to provide remote sellers with an exemption from collecting sales taxes.

The e-Fairness Coalition supports the Internet Tax Moratorium and Equity Act, which is introduced by Senators Dorgan, Enzi, Breaux, Chafee, Durbin, Hutchison, Graham, Lincoln, Rockefeller, Thomas, and Voinivich. The legislation will promote the growth of the Internet, and will allow states to ultimately require that remote sellers collect sales and use taxes just as traditional retailers do today. It promotes startup Internet retailers by having a de minimis threshold of $5 million in gross annual sales, has reasonable compensation for tax collection by sellers, and uniform order procedures.

The e-Fairness Coalition opposes S. 288, the Wyden-Leahy bill, primarily because it would impose unreasonable burdens on the states during the simplification process without ultimately providing them with a mandate to require that remote sellers collect.

Thank you, Mr. Chairman, and I welcome any questions.

[The prepared statement of Mr. Lowy follows:]

PREPARED STATEMENT OF PETER LOWY, CEO, WESTFIELD AMERICA; FOUNDING CHAIRMAN, E-FAIRNESS COALITION

Introduction

Good morning Mr. Chairman, Mr. Ranking Member and Distinguished Members of the Committee. Thank you for inviting me to discuss with you the issues surrounding Internet taxation and specifically whether Congress should extend the Internet Tax Freedom Act, and if so, what changes may be needed. I appreciate this opportunity and commend your efforts to include diverse views in the Senate's consideration of these important issues.

I am the CEO of Westfield America, which owns a portfolio of 39 super regional and regional shopping centers across the country. I am also the Founding Chairman of the e-Fairness Coalition, which includes brick-and-mortar and online retailers, realtors, retail and real estate associations, as well as publicly and privately owned shopping centers. The e-Fairness Coalition also includes high tech related companies such as Gateway and Vertical Net. Through these companies and associations our Coalition represents 1 in 5 American workers on this issue.

Let me be clear. The e-Fairness Coalition advocates a level playing field for sales and use tax collection for all retailers. We also support the continued growth of the Internet and do not support any form of discriminatory taxes or taxes on Internet access. However, the government should not provide preferential sales tax treatment based solely upon the distribution system used to sell goods. Requiring brick and mortar retailers to collect sales taxes while exempting their online competitors is fundamentally unfair, and presents a glaring national problem that requires Congressional action. Therefore, equitable collection of the sales tax needs to be addressed concurrently with an extension of a moratorium on discriminatory taxes and taxes on Internet access.

Supreme Court Invites Congressional Action

In 1992, the Supreme Court ruled in *Quill v. North Dakota* (504 U.S. 298) that the Due Process Clause of the United States Constitution did not bar enforcement of the state's use tax if the vendor purposefully directed its activity toward the state, even if the vendor had no physical presence in the state. At the same time, however, the Court reaffirmed the Commerce Clause rule of *National Bellas Hess* that an out-of-state vendor must have a physical presence in the state in order to be required to collect use taxes on sales into the state. In the decision, the Court reasoned, "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." *To date, the Quill decision's invitation for Congressional action has been unanswered.*

Under *Quill,* the Court indicated that any further refinements of the Commerce Clause rule of physical presence must emanate from Congress in light of its authority to "regulate Commerce with foreign nations, and among the several states." Justice Stevens addressed this in his opinion in *Quill:*

> "No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. See *Prudential Insurance Co. v. Benjamin,* 328 U.S. 408 (1946). Indeed, in recent years Congress has considered legislation that would "overrule" the *Bellas Hess* rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *Bellas Hess* that the Due Process Clause prohibits states from imposing such taxes, but today we have put that problem to rest. Accordingly, Congress is now free to decide whether, when, and to what extent the states may burden interstate mail-order concerns with a duty to collect use taxes."

Therefore, the e-Fairness Coalition urges Congress to use its Commerce Clause authority, to which the Supreme Court emphatically deferred, to assist states by enacting federal legislation to ensure a level playing field.

Need for a Level Playing Field

I believe we must have a level playing field for three reasons: (1) the current sales tax system is broken—it simply does not work in the "clicks and bricks" environment; (2) equity or "fairness"; and (3) states rights—that is the rights of states to set their own tax policy.

Closing the Loophole: The Current Consumption Tax System is Broken

The most urgent issue facing the Senate is the viability of the current consumption tax system. No longer are we looking at catalog sellers who owned a small percentage of the marketplace, we are discussing the ability of states to maintain their revenues and to provide needed services within the current system. The General Accounting Office (GAO) estimated in June 2000 that state and local revenue losses from remote sales could be as much as $20 billion by 2003.

The current sales tax system does not work in today's competitive business environment. Due to market realities, brick-and-mortar retailers are forced to respond to their online, tax-free competitors by setting up their online stores as separate subsidiaries. This corporate structure allows the online store to avoid physical nexus rules and the corresponding sales tax collection responsibilities. These "dot.com" subsidiaries only collect sales taxes in states where they have a warehouse or a headquarters. For example, K-Mart's online store, bluelight.com, only collects sales taxes in California and Ohio; Barnes and Noble.com only collects in New Jersey, Ne-

vada, New York, Tennessee and Virginia; Wal-Mart.com only collects in Arkansas, California, Ohio and Utah. As long as this system is in place, more and more retailers will do the same.

I have attached two items, which discuss this very subject. The first, an E-Commerce Tax Alert article from March 2000, describes how to set up a subsidiary to avoid sales tax collection responsibilities. The articles states that, "Internet tax headaches and the accompanying competitive disadvantages may be avoided by setting up a nexus-breaking subsidiary to shield transactions from sales tax collection duties in all but a few instances." The second attachment is drawn from the www.thewebstoreguide.com. That piece outlines for consumers how to avoid paying sales tax and also refers to the growing practice of setting up separate Internet entities "just to avoid having to charge customers sales tax."

Another tactic currently employed by a number of retailers is the installation of kiosks with Internet terminals in their physical stores. A customer can today enter the store, sample or try on the merchandise, have the sales person order the merchandise over the Internet, and have it delivered to the consumer and avoid charging and collecting the sales tax. While the law is still unclear on this issue, it is possible that a consumer may also purchase goods on the Internet and then return those items to a physical store. Those retailers may argue that this would not establish nexus as the Internet business has contracted with the physical store to accept returns. As more and more retailers place internet kiosks in their physical stores, states will have to rely on the consumer to voluntarily pay the use tax owed, devise a system to track the sale or delivery of remote sales, or forego the sales tax. This, I believe, is the major risk that Internet retailing presents for state and local revenues.

However, I would like to note that most of the country's largest retailers, who—in order to compete in the Internet economy—are forming these subsidiaries under the current law, would rather not be forced to do so. In fact, many are members of the e-Fairness Coalition. They recognize that the current consumption tax system is inequitable and support providing a level playing field for all retailers. The nation's largest on-line retailers, such as Wal-Mart, are also the nation's largest physical retailers—and they are willing to forsake short-term advantages for a collection system that is fair for all.

Since even in-store sales can now be set-up to avoid sales tax collection, the question is no longer whether pure Internet sellers should collect sales taxes; the question is where will states go to make up for the loss of revenue due to the explosion of the dot.com subsidiary. Will it be increased personal or commercial property taxes—or will states cut funds for education, police, and roads?

Fairness in the Consumption Tax System

The issue of equity—or "fairness " is not a question of whether there should be a consumption tax on goods and services, but rather, if a state chooses to have a consumption tax, should it be implemented equally. Simply put, there is no logical argument that supports taxing the same retail transaction differently depending on the delivery system. The market place should determine sales decisions, not discriminatory tax policies.

It is bad policy and bad economics to have a tax policy that favors one group of businesses over another when both groups are selling the same products to the same consumers into the same localities. Tax policy should not distort the free enterprise system by picking winners and losers in the marketplace. Consumers should make their buying decisions based on price, availability, service and convenience. They should not be influenced by discriminatory tax policy.

States Rights

The states, and not the Federal Government, should have the right to impose, or not impose, consumption taxes as they see fit. The reality is that education and other essential services are funded largely by the states, especially through sales taxes. Passing an extension of the moratorium without taking steps toward a comprehensive solution would send a clear signal to the states that Congress is willing to ignore a major, national inequity in order to provide some businesses with preferential tax treatment. This would halt the substantial progress the states have made in simplifying and unifying their sales tax systems, and may force states to consider raising property or income taxes to make up for the lost revenues.

I firmly believe that Congress should allow states to require all remote sellers to collect and remit sales taxes on deliveries in that state provided that states and localities dramatically simplify their sales and use tax systems. Simply put, remote retailers—that is Internet and catalog retailers—should be subject to the same sales tax collection responsibilities as traditional or Main Street retailers, if the states are

successful in simplifying their sales tax systems. Once the states simplify, thereby lifting administrative burdens off of retailers, there is no reason to provide remote sellers with an exemption from collecting sales taxes.

The e-Fairness Coalition believes that states should have the right to either opt in—or not opt in—to a compact that would require simplification and decide for themselves whether or not to require collection. If a Governor of a state believes that remote sellers should be exempt from having to collect use taxes—they will maintain their right to not collect taxes. However, if another state chooses to require collection and meets simplification criteria set out by the Congress, that state should be given the mandate to require collection. Further, if a state does not currently collect sales tax, they would not be required to do so. Pure and simple, this is an issue of federalism and of states' rights.

Support for the "Internet Tax Moratorium and Equity Act"

That is why the e-Fairness Coalition supports a comprehensive solution to this issue. We support the "Internet Tax Moratorium and Equity Act," which was introduced last week by Senators Dorgan, Enzi, Breaux, Chafee, Durbin, Hutchison, Graham, Lincoln, Rockefeller, Thomas, and Voinovich. This legislation will (1) promote the continued growth of the Internet and (2) will allow states to ultimately require that remote sellers collect and transmit sales and use taxes just as traditional retailers do today.

I would also like to note that the "Internet Tax Moratorium and Equity Act" promotes the growth of Internet-related entities through such provisions as an exemption from use tax collection requirements for remote sellers falling below a de minimus threshold of $5 million in gross annual sales; reasonable compensation for tax collection by sellers; and uniform audit procedures.

Opposition to S. 288

The e-Fairness Coalition opposes the language found in S. 288, introduced by Senators Wyden and Leahy. Our opposition to this bill is based on a number of specific factors, the most basic of which is that this bill would impose unreasonable burdens on the states during the simplification process without ultimately providing them with the authority to require that remote sellers collect sales taxes.

Section 4(b)(1)(B) of the Wyden bill requires uniformity among all states "in which a seller is located or does business." In other words, under the Wyden bill, no state could require a seller to collect use taxes if any single state in which that seller "is located or does business" had a dissimilar "tax, procedure, standard, or system." Thus, for any state to institute a comprehensive collection system, uniformity would be required in all 50 states. Any requirement that all, or almost all, the states adopt uniform measures as an initial threshold before any collection authority is granted is unduly onerous and will likely never be met.

Second, unlike the Internet Tax Moratorium and Equity Act, S. 288 requires any "simplified sales and use tax system for remote sales" to have a single statewide rate for all sales subject to use tax. While the Coalition may ultimately agree to support legislation (such as S. 2775 introduced in the 106th Congress) that includes one use tax rate per state, we do not deem it *necessary* to limit states to one rate per state as a prerequisite to a grant of authority to require collection by remote sellers.

Third, the e-Fairness Coalition considers it absolutely essential that states be given some assurance that if they enact extensive sales and use tax simplifications specified by Congress, they will receive authority to require remote sellers to collect use taxes. Without at least the "sense of the Congress" that compliance with Congressional criteria should result in the grant of such authority, state lawmakers will have great difficulty enacting any meaningful simplification.

There is no such assurance in the Wyden bill. This means that under the Wyden bill, states would have less incentive to enact controversial simplification measures. Proponents of simplification may have difficulty getting such measures passed by state legislatures when critics would complain that simplification and conformity with federal guidelines might well go entirely unrewarded.

Fourth, the Wyden bill would expressly preclude the overruling of Quill corp. v. North Dakota. Section 5(a) reserves to the Congress the exclusive authority to change existing nexus law for the collection of sales and use taxes. This provision would be effective even if Congress did not grant any collection authority over remote sales. It would therefore freeze current nexus law with no chance of redress in the Supreme Court, even if the states simplified their sales and use tax systems to the point that the Court might otherwise find that they did not burden interstate commerce.

Finally, we oppose S. 288 because the Wyden bill includes a provision regarding business activity taxes—an issue that is not addressed in the current Dorgan, Enzi

et al bill. The e-Fairness Coalition does not believe that restrictions on the application of business activity taxes should be imposed as a precondition to a grant of broader collection authority for sales and use taxes. These two issues are unrelated and should not be linked together. S. 288 would require as part of any "simplified sales and use tax system for remote sales" a restriction that is not related to sales and use taxes: a nexus standard for corporate income taxes and similar levies that is significantly narrower than the existing standard. The Wyden bill would exempt businesses from any business activity taxes in states where they do not own or lease property or have employees or agents more than 30 days a year. If this provision were applicable, it would almost certainly force many states to choose between continuing to lose use tax revenues and giving up a portion of the business activity taxes that they are currently collecting. It would be extremely unfortunate to create a situation where states that are willing to simplify their sales and use taxes are discouraged from doing so because of the possible curtailment of their ability to collect corporate income and franchise taxes.

Thank you for the opportunity to provide input on these important policy questions. I look forward to continuing to work with you to provide an equitable and streamlined sales tax collection system and I welcome any questions you may have for me today.

E-Commerce Tax Alert Vol 1 Issue 1 (March 2000)

Separate incorporation for e-commerce boosts tax planning strategies

As more established companies move on to the Internet, competitiveness with smaller dot-com operations creates questions over how to avoid sales and use tax nexus and keep the playing field level. While most large companies have nexus nationwide, small web-based upstarts often carefully choose where they locate with avoiding nexus in mind.

How can your company meet this challenge? Some experts advocate having an affiliate conduct your e-commerce operations. It sounds radical, but it represents solid tax-planning advice for some companies selling goods on the web. Internet tax headaches and the accompanying competitive disadvantages may be avoided by setting up a nexus-breaking subsidiary to shield transactions from sales tax collection duties in all but a few instances.

Perhaps the next memo you write should be addressed to those in charge of your company's electronic sales operation. Before they start selling, explore the possibility of creating a new subsidiary or affiliate to handle Internet sales and separate those sales from the nexus-creating activity your company already conducts.

Learn by example

Traditional businesses can learn from upstart cyberspace operations, which offer the convenience of shopping online and not collecting sales tax, suggests Jeremiah Lynch, a partner with Ernst & Young LLP in New York. Just as mail-order sellers avoid collecting sales or use taxes in most states, companies that rely on the Internet instead of a sales staff establish nexus only in states where they have offices, staff or property.

While brick and mortar businesses race to set up electronic commerce operations, many don't realize that a traditional structure establishes nexus for online transactions as well. Lynch says they miss an opportunity to reduce the number of states in which they must collect tax.

Just as companies once limited nexus through mail-order affiliates (Saks Holdings Inc., for example, set up Folio to handle its mail-order sales), they can establish affiliates to handle electronic sales. Lynch says the tactic limits nexus-creating activities to traditional transactions and offers customers a lower overall price-a necessity in a world where smaller competitors are selling the same goods with no sales taxes applied.

Amazon.com founder Jeff Bezos has said many times that he chose Washington state because it would not account for a large number of sales, thus allowing the bookseller to avoid nexus in major markets nationwide. When Amazon built an East Coast distribution center, it chose Delaware because that state has no sales tax.

Though Amazon's competitor, barnes-andnoble.com, was not created solely with tax considerations in mind, the online bookstore has nexus only in New Jersey, New York and Virginia, where it has a distribution center, its headquarters and its online site, respectively, explains Ben Boyd, vice president of communications for the online bookseller.

A competitive issue

Traditional companies must consider such factors because upstart competitors that sell exclusively on the Internet offer the same products without charging tax. Though consumers who purchase goods free of sales tax are supposed to remit use tax, most never do, and states rarely press the issue unless it involves business-to-business transactions.

If sales tax is a competitive issue for booksellers, imagine the implications of purchasing large-ticket items tax-free. When an online customer faces the choice of purchasing a $2,000 computer from a vendor who charges sales tax or one who doesn't, the decision is obvious, Lynch says.

Internet sales continue to climb, and whenever sales tax is a competitive issue, traditional retailers should at least consider setting up a separate affiliate for online transactions. "Too many businesses are not taking advantage of this," Lynch says. "There would be no reason not to form a separate company for electronic commerce."

Internet Sales Tax Guide

Ever wondered why only some online stores charge sales tax?

Never pay tax again! Simply follow these principles below to save!

1. If an Internet Store has a physical presence in the state that you are buying from, you will be charged that state's local sales tax.
2. If you buy from an internet store that isn't based in the state you are buying from, you will not be charged sales tax—great huh?
3. Even bricks and mortar stores count as a physical presence. Therefore it is much more likely that online sellers like Borders and Barnes&Noble will charge you sales tax because they have retail stores in most states
4. As a result of number 3, some companies are now even setting up separate internet divisions of there company, just to avoid having to charge customers sales tax. Good news for internet shoppers then!

Examples of taxing:

1. If you live in New York and buy from Bigwords.com, they do not have a physical presence in that state, so you won't be charged any sales tax.
2. If you live in New Jersey and buy from CDNOW, they have a physical presence in that state so they will charge you New Jersey's sales tax—currently 3 percent.

TheWebStoreGuide Sales Tax Advice

Take a look at the table below to see whether you will be charged sales tax, as this can save you extra dollars. This is especially true when the product you want to purchase costs the same price in more than one online store—pick the store that won't charge you sales tax. Or buy from 800.com, they are based in *Oregon which has no sales tax*! *Tough luck if you live in California*—its the worst state to live in for being taxed in—many online stores have a physical presence there! Basically, if you buy from a store that has a presence in the same state as you, you will always pay the local sales tax.

List of Stores and Where They Charge Sales Tax

Online Store (Click to Read Review)	States tax charged in	Comments
Amazon	WA	-
Barnes&Noble.com	TN, NJ, NY, VA	Separate online business
Bigstar.com	MN, NY, CA, NV	-
Borders.com	MI, TN	-
Buy.com	CA, TN, MA, IN	Many distribution centers
CDNOW	CA, PA, FL, NY, NJ	Many distribution centers
CD Universe	CT	-
Drugstore.com	WA	-
E-Toys	CA	-
Outpost.com	CT, OH	-
Petopia.com	CA, MN, OH, IL, NY, NJ, TN	Many distribution centers
VarsityBooks		
800.com	OR	Oregon has no sales tax!

Members of the e-Fairness Coalition include:

Alabama Retail Association
American Booksellers Association
American Jewelers Association
Ames Department Stores
Atlantic Independent Booksellers Association
CBL & Associates Properties, Inc.
Circuit City Stores, Inc.
Electronic Commerce Association
First Washington Realty Trust, Inc.
Florida Retail Federation
Gateway Companies, Inc.
General Growth Properties, Inc.
Georgia Retail Association
Great Lakes Booksellers Association
Home Depot
Illinois Retail Merchants Association
International Council of Shopping Centers (ICSC)
International Mass Retail Association (IMRA)
Kentucky Retail Association
Kimco Realty Corporation
K-Mart Corporation
Lowe's Corporation, Inc.
The Macerich Company
Michigan Retailers Association
Mid-South Booksellers Association
Missouri Retailers Association
Mountains & Plains Booksellers Association
National Association of College Stores
National Association of Convenience Stores
National Association of Industrial and Office Properties (NAIOP)
National Association of Real Estate Investment Trusts (NAREIT)
National Association of Realtors (NAR)
National Community Pharmacists Association
National Retail Federation
New England Booksellers Association
Newspaper Association of America
North American Retail Dealers Association

Northern California Independent Booksellers
Pacific Northwest Booksellers Association
Performance Warehouse Association
RadioShack Corporation
Regency Realty Corporation
Retailers Association of Massachusetts (RAM)
ShopKo
Simon Property Group
Southeast Booksellers Association
Southern California Booksellers Association
South Carolina Merchants Association (SCMA)
Target, Inc.
Taubman Centers, Inc.
The Gap, Inc.
The Macerich Company
The Musicland Group, Inc.
The Real Estate Roundtable
The Rouse Company
Variety Wholesalers
VerticalNet, Inc.
Virginia Retail Merchants Association
Wal-Mart
Weingarten Realty Investors
Westfield America, Inc.
(As of March 13, 2001)

The CHAIRMAN. Thank you, Mr. Lowy.
Mr. Comfort, welcome.

STATEMENT OF ROBERT D. COMFORT, VICE PRESIDENT OF TAX AND TAX POLICY, AMAZON.COM

Mr. COMFORT. Thank you, Mr. Chairman, Members of the Committee. My name is Bob Comfort, and on behalf of all my colleagues at Amazon.com I would like to express our gratitude at being invited here to testify before this Committee.

I am Amazon.com's vice president of tax and tax policy. Amazon opened its virtual doors in 1995 on a mission to use the Internet to transform book-buying into the easiest, most enjoyable shopping experience possible. Some 30 million customers today in more than 160 countries have made us the Internet's number one retailer, offering a wide array of consumer products.

As a proponent of widespread, low-cost access to the Internet and the opportunities it offers to Americans, Amazon fully supports congressional action to extend the Internet Tax Freedom Act's moratorium on multiple or discriminatory taxes. Extending the moratorium for a few years would be helpful, but a permanent moratorium would be preferable.

Although it is not directly related to the moratorium, it has been suggested here today that Congress should take this opportunity to define the circumstances in which states could require all remote sellers to collect sales taxes without imposing an unreasonable burden upon interstate commerce.

This would require the states to simplify their sales and use tax regimes and to achieve some degree of uniformity from state to state. If substantial simplification and uniformity were not achieved, imposition of a collection obligation in the absence of judicially defined nexus would continue to impose an unreasonable burden upon Internet sellers, as described in the Supreme Court's decisions, National Bellas Hess and Quill.

Amazon would support a properly focused effort among the states to bring their sales tax systems into conformity within the Constitution, as applicable to remote sellers. Amazon is quite concerned, however, that over the life of the streamlined sales tax project, most of the difficult decisions required to achieve substantial simplification and uniformity have either been deferred or completely removed from consideration.

Given this history, Amazon strongly believes that Congress must not authorize states to require all remote sellers to collect sales taxes based solely upon representations that the states will address somewhere down the road a variety of criteria for simplification.

To this end, Congress should provide the states with specific guidance about the criteria that Congress deems necessary for acceptable simplification of the current sales tax system. Each state would be free to decide whether or not it wished to make these changes to its sales tax systems in exchange for subsequent congressional approval. This process would respect state sovereignty, while providing motivation and a clear road map for simplification, and it would allow Congress to conduct a followup review to ensure that the states have indeed genuinely simplified their sales and use tax systems in order to eliminate the unreasonable burden on interstate commerce. I cannot emphasize this last point strongly enough, Mr. Chairman.

The states have repeatedly demonstrated inability or unwillingness to grapple with the issues that must be resolved in order to achieve genuine simplification. The streamlined sales tax project is only the most recent example. If the states are free to leave uniformity, sourcing, and compensation issues for future consideration while proclaiming that their systems have been streamlined, they will do just that.

Congress must review their actions at the end of the simplification process, not approve them in advance, otherwise, Amazon and all other remote sellers will lose their Commerce Clause protections, even though the unreasonable burden imposed upon our businesses by the crazy quilt of sales and use tax regimes would remain.

Congress must also provide a mechanism to ensure that states that are permitted to require remote sellers to collect tax will continue to comply with a congressionally mandated criteria for simplification and uniformity. If, in the future, a state chooses to diverge from these criteria, then the constitutional limitation set forth in National Bellas Hess and Quill will once again apply to that state.

Amazon believes that, at a minimum, states and localities must meet and maintain the following requirements for simplification and uniformity. Sales tax rates on remote sales must be determinable based solely on the geographic area information included in a customer's address.

Although a single, nationwide rate applicable to all remote sales would be the simplest approach, one rate per state would also work. Five-digit zip codes would be the smallest acceptable sales tax rate area, because consumers do not know, and remote sellers have no way of determining any smaller or different tax rate areas within those five-digit zones.

Uniform definitions and rules must define the sales tax base and provide specific rules regarding allocation of shipping and handling charges, coupons, discounts, and other charges to orders that contain both taxable and nontaxable goods. Uniform rules must also cover the refund of sales taxes in the case of customer returns where the seller retains shipping charges.

Uniform definitions and sourcing rules must be developed for the sale of digital goods such as downloaded music and software.

States must provide reasonable compensation to remote sellers for collecting the taxes. At a minimum, this compensation must encompass the cost incurred by remote sellers for credit card processing fees which are assessed as a percentage of the total amount of both the price of the item sold and the applicable sales tax.

Last, Mr. Chairman, state and local governments should be required to assist remote sellers in educating consumers on this issue by, for example, establishing a toll-free phone number and Internet website, and a direct mailing effort.

Mr. Chairman, Amazon.com appreciates your invitation to provide its views on this important public policy matter, and would welcome the opportunity to elaborate further.

Thank you.

[The prepared statement of Mr. Comfort follows:]

PREPARED STATEMENT OF ROBERT D. COMFORT, VICE PRESIDENT OF TAX AND TAX POLICY, AMAZON.COM

Mr. Chairman, Senator Hollings, and Members of the Committee, my name is Robert Comfort. I am Amazon.com's Vice President for Tax and Tax Policy. A pioneer in electronic commerce, Amazon.com opened its virtual doors in July 1995 with a mission to use the Internet to transform book buying into the easiest and most enjoyable shopping experience possible. Today, Amazon.com also offers consumer electronics, toys, CDs, videos, DVDs, kitchenware, tools, and much more. Some 30 million customers in more than 160 countries have made us the Internet's number one retailer.

Amazon.com is grateful for this opportunity to address the issue of Internet taxation. As a proponent of widespread, low-cost access to the Internet and the opportunities it offers Americans and the American economy, Amazon.com fully supports Congressional action to extend the Internet Tax Freedom Act's moratorium on multiple or discriminatory taxes on the Internet. Extending the moratorium for a few years would be helpful, but a permanent moratorium would be preferable.

Although not directly related to the moratorium, it has been suggested that Congress should simultaneously define the circumstances in which states could require all remote sellers to collect sales taxes, without imposing an unconstitutional burden upon interstate commerce. It is widely agreed that this would require the states to simplify their sales and use tax regimes and to achieve some degree of uniformity from state to state. If substantial simplification and uniformity were not achieved, any imposition of a collection obligation in the absence of judicially defined "nexus" would continue to impose an unconstitutional burden upon remote sellers, as described in the Supreme Court's decisions in National Bellas Hess and Quill.

Consequently, Mr. Chairman, Amazon.com urges Congress, should it decide to address the sales tax collection issue, to establish clearly defined goals for the states to achieve, and to scrutinize with care the results of their efforts, in order to assure Congress and the American people of adherence to the strictures of the Commerce Clause.

Amazon.com would support any properly focused effort among the states to bring their sales tax systems into conformity with the Constitution as applicable to remote sellers. Amazon.com is quite concerned, however, that over the life of the Streamlined Sales Tax Project, most of the politically difficult decisions required to achieve substantial simplification and uniformity have either been deferred or completely removed from consideration. Given this history, Amazon.com strongly believes that Congress must not authorize states to require all remote sellers to collect sales tax

based solely upon representations that the states will address, somewhere down the road, a variety of criteria for simplification.

Instead, Congress should provide the states with specific guidance about the criteria that Congress deems necessary for constitutionally acceptable simplification of the current sales tax system. The states should be free to decide whether or not they wish to make these changes to their sales tax systems, in exchange for subsequent Congressional approval. This process would respect state sovereignty while providing motivation and a clear roadmap for simplification. And it would allow Congress to conduct a follow-up review to ensure that the states have indeed genuinely simplified their sales and use tax systems in order to eliminate the unconstitutional burden on interstate commerce.

I cannot emphasize this point too strongly, Mr. Chairman. The states have repeatedly demonstrated inability or unwillingness to grapple with the issues that must be resolved in order to achieve genuine simplification. The Streamlined Sales Tax Project is only the most recent example. If the states are free to leave uniformity, sourcing, and compensation issues for "future consideration," while proclaiming that their systems have been streamlined, they will do just that. Congress must review their actions at the end of the simplification process, not approve them in advance. Otherwise, Amazon.com and all other remote sellers would lose our Commerce Clause protections, even though the unreasonable burdens imposed upon our businesses by the crazy-quilt sales and use tax regimes would remain.

Congress must also provide a mechanism to ensure that states that are permitted to require all remote sellers to collect sales tax will continue to comply with the Congressionally mandated, constitutionally required criteria for simplification and uniformity. If, in the future, a state chooses to diverge from these criteria, then the constitutional limitations set forth in National Bellas Hess and Quill must once again apply to that state.

Amazon.com believes that, at a minimum, states and localities must meet and maintain the following requirements for simplification and uniformity:

- Sales tax rates applicable to remote sales must be determinable based solely on the geographic area information included in a customer's address. Thus, although a single, nationwide rate applicable to all remote sales would be the simplest approach, Amazon.com does not believe it would be necessary; one rate per state would work very well. Five-digit zip codes would be the smallest acceptable sales tax jurisdiction areas, because consumers don't know—and remote sellers would have no way of determining—any smaller or different tax rate areas.
- Uniform definitions and rules must define what is includable in the sales tax base, and provide specific rules regarding the allocation of shipping and handling charges, coupons, discounts, and other charges to orders that contain both taxable and nontaxable goods. Uniform rules also must cover the refund of sales taxes in the case of customer returns where the seller retains shipping charges.
- Uniform definitions and sourcing rules must be developed for the sale of digital goods, such as downloaded music and software.
- States must provide reasonable compensation to remote sellers for collecting sales tax. At a minimum, such compensation must encompass the cost incurred by remote sellers for credit card processing fees assessed as a percentage of the total amount of both the price of the item sold and the applicable sales tax.
- Lastly, state and local governments should be required to assist remote sellers in educating consumers on this issue by, for example, establishing a toll free phone number, an Internet website, and a direct mailing effort.

Mr. Chairman, Amazon.com appreciates your invitation to provide its views on this important public policy matter and would welcome the opportunity to elaborate further on these comments.

The CHAIRMAN. Thank you.
Ms. Harchenko, welcome.

STATEMENT OF ELIZABETH HARCHENKO, DIRECTOR, OREGON DEPARTMENT OF REVENUE

Ms. HARCHENKO. Thank you, Mr. Chairman, and Members of the Committee. I am Elizabeth Harchenko, Director of the Oregon De-

partment of Revenue and chair of the Multistate Tax Commission. It is an honor for me to be here before this Committee today.

The Multistate Tax Commission is an interstate compact agency with 45 participating states, including the District of Columbia. The commission works to preserve federalism and to promote fairness, uniformity, and simplification in state and local tax systems. I thank you for the opportunity to address the most important issue of federalism facing our nation today.

That issue is whether Congress will join in partnership with the states to support their efforts to ensure that all commerce, from local to global, is treated in an equal, uniform, and nondiscriminatory manner by state and local tax systems. A federal-state partnership is essential to support the free flow of commerce and fair competition in the national marketplace. Forging this partnership will influence the speed and the extent to which the benefits of modern technology and economic prosperity spread from one state and region to another.

Finally, developing this partnership will shape the future of federalism. It will determine whether states and local governments will be able to perform the role and functions that the nation, including the Congress, expects them to perform in supporting the national economy and ensuring the quality of life for all citizens, and doing so efficiently and effectively.

Why is it so critically important that Congress join the states in this partnership? Because the principles on which our nation was founded recognized that the states would work cooperatively through our National government, and that the National Government has the power and resources to support and participate in these joint efforts.

All states and local governments tax their own residents and nonresidents who engage in local and interstate business through different mixes of income taxes, business activity taxes, sales and use taxes, excise taxes, and other kinds of taxes, depending upon local circumstances and needs.

Regardless of the types of taxes state and local governments choose to levy, those taxes must apply fairly to all forms of commerce. In this regard, we should all understand it was never the constitutional intent of the Commerce Clause to deprive the states of the ability to ask for a fair share contribution from interstate businesses to support government service.

Tax policy should not play favorites. Similar economic activity should be taxed in similar ways to support the free flow of commerce and equal competition, so balance and equity in taxation between local and interstate commerce is economically essential and constitutionally appropriate.

The greatest imbalance in state and local taxation arises in the area of collection of sales and use taxes. There is no sound tax policy that supports a tax being collected on a shirt, or a music recording, or a computer sold through a local store but not collected when the same product is sold by mail order, or through the Internet.

States recognize that we must do our part to correct this imbalance by simplifying state and local tax structures so that the collection of the taxes does not create an undue burden on interstate commerce.

Through the streamlined sales tax project the states, working side by side with business, have developed measures that will radically simplify sales and use taxes and eliminate undue burdens that may be associated with their collection. In light of this development, Congress should join in partnership with the states and act to level the playing field between local and remote commerce by requiring remote sellers with sales greater than a national threshold amount to collect sales and use taxes for those states implementing the streamlined sales tax project recommendations. Doing so will achieve fundamental fairness and nondiscrimination in the application of sales and use taxes between local business and interstate commerce.

Within the context of this partnership, Congress also needs to examine the technical language in the Internet Tax Freedom Act should Congress choose to extend the Act, which may exacerbate existing inequities in sales and use taxation. Governor Geringer described those in a little more particularity during his testimony, and they have been referred to specifically in the written submissions.

In addition to encouraging a federal-state partnership, we ask Congress to refrain from making any of the current inequities worse. In particular, Congress should not enact new restrictions on the ability of states to tax a fair share of the income of multistate enterprises.

Proposals advanced by some business interests would dramatically change current law, and would simply create and multiply within the business activity tax realm the same problems that have existed for sales and use taxes. These proposals would allow a select group of companies to avoid their fair share of state and local taxes and to create a resulting shift in that burden to wage-earners, small businesses, traditional manufacturing and natural resource industries, those who are captive within the taxing state, and cannot avoid taxation.

Congress should recognize that in an era when companies can make substantial quantities of sales and earn substantial income within a state from outside that state, the concept of physical activity as a standard for state taxing authority is inappropriate.

Among other problems, this concept discourages the free flow of investment across state boundaries, and restricts the spread of economic prosperity from areas of initial investment to all states and regions. If a company is subject to state and local taxes only when it creates jobs or facilities in a state, then many companies will choose not to do so. They will stay where they are, and the states that would like to attract them will lose the opportunity for additional jobs in their states. Instead, companies will choose to make sales into our states and earn income from them without investing in them.

If Congress ties states to a physical activity concept for a business activity taxing jurisdiction, Congress will be choosing to freeze investments in some areas and prevent the flow of new technology and economic prosperity in a balanced way across the entire nation. Congress should recognize that a standard of physical activity for tax nexus is not in the best interests of our nation, and that sound economic policy requires adoption of practical concepts of

economic nexus as a standard for the application of state and local taxes.

Finally, let me address how the nation as a whole, its corporate citizens, and its taxpayers, benefit from strong state and local governments and a strong federal-state partnership. The nation relies on states and local governments to educate our citizens for a modern economy and society. It relies on states and local governments for civil order, and a framework of commercial law that supports orderly commerce.

The nation relies on states and local governments to provide the infrastructure over which commerce flows. It relies on states and local governments to adopt policies that ensure the flow of electrical energy across state boundaries so that the new technology-based economy can flourish.

The genius of our system of federalism is that our nation relies on states and local governments to tailor vital services of national benefit to fit local circumstances. If this system of federalism is to continue to serve this nation well in the new century, then Congress and states must form a partnership to ensure that interstate commerce participates on a full and equal basis to help finance the state and local services that benefit the entire nation.

Mr. Chairman, thank you very much for the opportunity to address the Committee. I am happy to answer any questions that you or the Members may have.

[The prepared statement of Ms. Harchenko follows:]

PREPARED STATEMENT OF ELIZABETH HARCHENKO, DIRECTOR, OREGON DEPARTMENT OF REVENUE

The Multistate Tax Commission is an organization of state governments that works with taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Created by an interstate compact, the Commission:

- encourages tax practices that reduce administrative costs for taxpayers and states alike;
- develops and recommends uniform laws and regulations that promote proper state taxation of multistate and multinational enterprises;
- encourages business compliance with state tax laws through education, negotiation and enforcement, and
- protects state fiscal authority in Congress and the courts.

Forty-five states (including the District of Columbia) participate in the Commission, as Compact Members (21), Sovereignty Members (3), Associate Members (18), and Project Members (3).

On February 26, 2001, Senators McCain, Dorgan, Enzi, Hollings, Kerry, Wyden, and Voinovich requested input from interest groups on issues relating to the potential extension of the Internet Tax Freedom Act and simplification of sales and use taxes in general. The Commission is committed to achieving equitable, uniform and non-discriminatory taxation and to securing the benefits of federalism that arise from preserving the proper authority of the states within our nation. The Commission strongly supports state efforts to streamline and simplify sales and use tax laws to alleviate undue administrative burdens on interstate sellers. In the context of simplification of sales and use taxes, the Commission supports the equitable collection of sales and use taxes on remote sales by sellers exceeding a threshold level of sales. The Commission supports the development of a partnership between Congress and the states to accomplish the equitable collection of sale and use taxes. The Commission opposes new federal restrictions on state authority to levy business activity taxes because the proposed restrictions would diminish the proper authority of states in our federal system and would undermine equity in taxation by allowing a select group of companies to avoid their fair share of taxes. These proposals would

unfairly shift the state and local tax burden to wage-earners, small businesses and traditional manufacturing and natural resource firms. As a membership body, the Commission has not taken a position on extension of the Internet Tax Freedom Act. However, the Commission recognizes certain technical difficulties with legislative language in the Act that appears to undermine the goals of equity, uniformity and non-discrimination and asks Congress to examine that language if it considers extension of the Act in any form.

Attached is the response from the Multistate Tax Commission to the Senators on issues related to the taxation of remote commerce, the simplification of sales and use tax laws, and technical issues relating to the Internet Tax Freedom Act.

March 6, 2001

Hon. JOHN MCCAIN,
U.S. Senate,
Washington, DC.

Hon. ERNEST HOLLINGS,
U.S. Senate,
Washington, DC.

Dear Senators McCain and Hollings:

Thank you for your letter of February 26, 2001, in which you request input from the Multistate Tax Commission (MTC) on issues related to the potential extension of the Internet Tax Freedom Act. The Multistate Tax Commission appreciates the opportunity to provide you with its position on issues of state and local taxation of interstate commerce raised in your letter. These views are based on a fundamental commitment to achieving equitable, uniform and non-discriminatory taxation and to securing the benefits of federalism that arise from preserving the proper authority of the states within our nation.

Tax neutrality is essential to achieving equity, uniformity and non-discrimination. Tax policy should not play favorites: similar economic activities should be taxed in similar ways to support the free flow of commerce and equal competition in the national marketplace. States within our nation should be treated in an equal and even-handed manner in support of the economic health, fiscal stability and governmental authority of all. The national economy and the free flow of commerce benefit from the services and laws provided by state and local governments and the efficient tailoring of those services to fit local circumstances. That is the genius of our federal system: by preserving state sovereignty, flexible federalism efficiently supports the national economy.

The MTC provides here a summary response to the points raised in your letter. We will supplement this summary within a few days with a white paper discussing these issues in greater detail.

Should Congress allow states to require all remote sellers to collect and remit sales taxes on deliveries into that state provided that states and localities dramatically simplify their sales and use tax systems?

Yes, provided that remote sellers whose sales do not exceed a specified level of *de minimis* national sales (a "sales threshold standard") be exempt from the requirement to collect and remit state sales or use taxes. The recommendations of the Streamlined Sales Tax Project will dramatically simplify sales and use taxes to a degree sufficient to require remote sellers above a sales threshhold to collect those taxes. Congress should level the playing field between local and remote sellers to advance tax fairness, increase national economic efficiency and growth, and provide for more balanced economic development among states and communities. Congress should form a partnership between the states and the Federal Government and require remote sellers to collect sales and use taxes once the specified minimum of states have enacted the simplifications recommended by the Streamlined Sales Tax Project. Finally, in light of newly emerging business operations and technologies, Congress should revisit certain provisions in the "multiple and discriminatory" definitions in the Internet Tax Freedom Act if that act is extended. Those provisions, ironically, may increase tax discrimination against local retailers, instead of eliminating that discrimination.

There is no dispute that sales and use taxes are an indispensable element of state and local government finances. No one seriously disputes that such a tax, to be efficient and effective, is best collected at the retailer level—just as federal and state individual income taxes are most efficiently collected through employer withholding.

The inability of the states to require collection of sales and use taxes on remote sales subjects local retailers to unfair competition from remote sellers. Moreover,

this substantial inequity violates the standards of tax neutrality and thereby reduces overall economic efficiency and national growth by diverting the allocation of capital away from its most efficient uses. In practical terms, this inequity is a source of additional pressure on the viability of local businesses in communities across the nation—businesses that the marketplace would treat more kindly if only the rules were fair and even-handed.

The inability of the states to require collection of sales and use taxes on remote sales creates a second inequity. It allows remote sellers to benefit from state and local services without helping to collect the taxes that finance those services. The state and local services that benefit remote sellers and, indeed, the national economy are extensive and include: education, university research, state and local infrastructure, public safety, commercial laws, the state court systems, environmental management and energy conservation and development, among others. A sampling of just some of these benefits includes: states and localities provide the roads used by the contract carrier to deliver goods purchased by remote commerce; states provide the courts that enforce the security interest of the remote seller in an installment sale to ensure proper payment; states finance the schools and universities that educate workers for the high technology industry and provide markets for computers and software . . . and the examples go on. Thus, remote sellers should bear the responsibility of participating in the process of financing these services.

The inability of the states to require collection of sales and use taxes on remote sales leads to yet a third inequity. The failure of a large portion of remote sellers to collect sales and use taxes typically allows their customers to escape paying sales and use taxes they owe. In the case of Internet purchases that require ready access to a properly connected computer, these customers tend to have higher incomes than the general population. The ability of higher income individuals to avoid the sales and use tax on purchases from remote sellers puts pressure on state and local governments to keep the rates of sales taxes artificially high to support needed services. This shifts the tax burden to those with the least ability to pay and increases the regressive nature of the sales tax.

In addition, the failure of remote sellers to collect sales and use taxes confuses the public into believing that tax is not due on remote sales. Accordingly, when states attempt—as they increasingly have in recent years—to collect from purchasers the lawfully due use tax, the state is wrongfully accused of imposing a new tax when, in fact, the state is only seeking to collect a tax that has been on the books for decades. By failing to collect the tax, remote sellers first create a collection problem for the states and then make it more difficult for states to solve that problem.

Finally, the current judicial interpretation of nexus for use tax—so-called "physical presence nexus"—actually prevents the free flow of interstate commerce and detracts from balanced economic development by acting as a barrier to capital investment flowing from one state into another. Companies have a disincentive to create jobs and invest in facilities in different states because once they establish facilities in the state they will be subject to a sales and use tax collection requirement. The ability of companies to make substantial sales into a state, but not collect that state's sales and use taxes, distorts investment decisions. This circumstance tends to "freeze" economic development in states where certain activities originate and prevents the flow of investment into other states in a balanced manner. Thus, the current state of case law, absent congressional action, unwittingly favors some states and regions and prevents investment and prosperity from flowing evenly to all areas of the nation.

Congress can remedy this state of affairs by adopting—consistent with the nature of the modern economy and the principle of tax neutrality—a practical sales threshold standard requiring remote sellers with sufficient sales to collect sales and use taxes. Companies exceeding the sales threshold would no longer refrain from investing in a state out of a fear the investment would trigger a new collection requirement. Instead, the investment would be evaluated entirely on its free market merits. Moving to a sales threshhold standard for sales and use tax collection for remote commerce will eliminate a barrier to the free flow of investment across state boundaries and help generate more balanced economic development across the nation.

In summary, the states' inability to require the collection of sales and use taxes on remote sales constitutes bad tax policy, is inequitable and causes real economic damage. It is unfair to ask local retailers to compete with remote sellers who do not collect tax on identical sales, and that unfair competition creates economic pressures on local businesses and the communities that rely on them. It is unfair for remote sellers to escape collecting the taxes that finance state and local services from which they benefit, and that failure impairs the proper financing of those services. It is unfair that higher income taxpayers can disproportionately avoid sales

and use taxes, and that shift in the tax burden makes it harder for lower income families to make ends meet. It is unfair that current standards of sales and use tax nexus tend to freeze economic development in the places of initial investment and prevent prosperity from flowing evenly to all states and regions of the nation. Congress as a matter of equity and sound economic policy should require remote sellers with sales above a certain threshhold to collect sales and use taxes in conjunction with state efforts to streamline the administration of those taxes.

States recognize that the current sales and use taxes need to be updated to fit with the modern economy. Forty states—thirty-two voting states and eight observers—have undertaken the Streamlined Sales Tax Project with the active involvement of the multistate business community. The project's work is described in greater detail below. At this point it is sufficient to note that the project has identified the critical areas of change needed to make existing sales and use taxes work efficiently in the modern national economy. Congress should enact a "sales threshhold" remote sales collection requirement—subject only to a subsequent congressional veto—when a sufficient number of states have adopted an interstate compact implementing simplification in the areas identified by the Streamlined Sales Tax Project. The federal-state partnership approach will achieve a level playing field in sales and use tax collection based on dramatic simplification of those taxes. Such a role for Congress was clearly envisioned by the framers of our Constitution. If Congress is not prepared to enter into this partnership with the states, it should refrain from specifying the details of simplification and should not preempt the sovereign right of states to have full and fair access to the courts to secure judicial approval of simplifications they may enact.

One final point. The combination of two obscure, ambiguous provisions in the definition of "discriminatory taxes" in the Internet Tax Freedom Act [Section 1104 (A)(iii) and (B)(ii)(II)] may be inadvertently encouraging new inequities among retailers. Some retailers are placing Internet kiosks in local stores, making sales through those kiosks and allowing customers to return goods to those local stores. A portion of these retailers collect sales and use taxes on their Internet sales. Other retailers employing this practice do not. States find no legal justification for the retailers that fail to collect the sales taxes, despite their physical presence, other than the possibility of an ill-advised reading of the two provisions cited above whose language is manifestly unclear. While states would dispute this unfortunate reading of these provisions, their ambiguity should not be creating new discrimination in the marketplace. They should simply be eliminated if Congress chooses to extend the Internet Tax Freedom Act.

Should goods purchased from remote sellers be taxed at the same rate as goods purchased through more traditional means (e.g., in-store sales)?

Yes, it is sound tax policy for the same goods to be taxed at the same rate within any given jurisdiction. Further, the U.S. Constitution requires that goods sold by remote means be taxed at a rate no higher than goods sold locally, and many state constitutions effectively require goods sold by different means to be taxed equally.

Applying the same rate to different modes of selling fulfills the fundamental economic precept that taxes should operate neutrally. Otherwise a tax system in effect chooses winners and losers and displaces the free market determination of efficient and viable economic activity. Once the law selects economic favorites, the interests that benefit from the favored treatment work to preserve their privileged status to the detriment of non-favored players without regard to any underlying need for such protection. Taxing the same good at different rates based on delivery would perpetuate all of the inequities and problems associated with the present circumstance where many remote sales are taxed at a zero rate while local sales of the same goods are taxed at a full rate.

Furthermore, the U.S. Constitution requires that tax rates on products sold in interstate commerce be no higher than on products sold locally. The states accept this fundamental understanding of non-discrimination that supports the national market in our federal union. Traditional local commerce must bear its fair share of taxation as much as interstate commerce, including electronic commerce. The rule is well established that the tax rate imposed on sales by remote sellers not exceed the rate that is imposed on goods sold through the more traditional means. Thus, no further congressional action is needed to ensure equity in tax rates applied to both local and remote sales.

What simplifications in state and local sales and use tax laws would you consider important to reduce the burden of compliance?

The recommendations of the Streamlined Sales Tax Project will dramatically simplify the sales and use tax and will reduce compliance burdens for multistate busi-

nesses sufficiently to support Congress allowing states to require remote sellers exceeding a specified sales threshhold to collect state and local sales taxes. The work of having multistate businesses identify the areas of simplification actually began over six years ago with the industry-led MTC Sales Tax Simplification Committee created by the Multistate Tax Commission. Business representatives on that Committee from the American Institute of Certified Public Accountants (AICPA), the Committee on State Taxation (COST), the National Tax Association (NTA), the Tax Executives Institute (TEI) and the Institute for Professionals in Taxation (IPT) completed an inventory of desired areas of simplification in 1997. That process has continued through several other regional and national projects and studies involving multistate businesses, including the National Tax Association Communications and Electronic Commerce Tax Project cited in the Internet Tax Freedom Act. This extensive process of multiple state-industry consultation has reached a sound conclusion in the recommendations of the Streamlined Sales Tax Project. Congress can with confidence endorse—as a complete, comprehensive and sufficient package—the areas of simplification addressed by the project in legislation authorizing states to require collection of sales and use taxes by remote sellers.

Perhaps the most significant area in which simplification is required—and is being addressed effectively by the Streamlined Sales Tax Project—is in reducing the number of sales and use tax returns and reducing the number of tax bases in each state and all of its local entities. Using the benefits of statewide administration, the number of returns a retailer is required to file can be reduced from hundreds nationwide to one per state. Concurrently, the number of tax bases should be reduced so that retailers will be required to keep track of one tax base per period for each state into which it makes sales. These changes radically reduce the compliance burden of multistate retailers. A few dozen returns will suffice for even the largest retailers where hundreds of returns were required before. Smaller retailers will see comparable reductions.

The other areas of simplification being addressed by the Streamlined Project include:

- a centralized, one-stop, multistate registration system for participating sellers;
- uniform definitions for goods or services;
- uniform rules for attributing transactions to particular taxing jurisdictions;
- uniform procedures for handling sales that are exempt from sales and use taxes by virtue of the nature of the purchaser or the use of the purchased item and relief from liability to the states for sellers that rely on such state procedures;
- uniform procedures for certifying software that sellers may elect to determine applicable taxes and relief from liability to the state for sellers that rely on such software;
- simplified, uniform procedures for claiming bad debts;
- a uniform format for tax returns and remittances; consistent electronic filing and remittance methods;
- uniform audit procedures;
- appropriate protections for consumer privacy;
- limitations on the frequency with which local units of government may change their sales and use tax rate and the provision of adequate notice to sellers of the effective dates of such changes;
- standardized procedures requiring each state to provide sellers with the information necessary to assign the appropriate sales and use tax rate to any transaction attributed to the state and relief from liability to the states for sellers relying on such information provided by a state;
- and a study of the cost of collection by retailers before and after simplification.

In total, the elements addressed by the Streamlined Sales Tax Project are the areas of simplification most important to reducing burdens of compliance with sales and use taxes.

Does simplification necessarily mean that states will have to develop one tax rate per state to apply to a certain taxable good?

No. All of the simplification benefits of one rate per state can be achieved largely through the approach developed by the Streamlined Sales Tax Project. That approach combines uniform, strategic simplifications in tax policy with technology. Those simplifications include: (a) limiting rate changes to quarterly periods, (b) pro-

viding uniform advance public notice of the changes, and (c) relieving enterprises of liability for errors in local rates if they use databases of local rates provided by states. Congress, in the Mobile Telecommunications Sourcing Act, Pub. L. 106–252, 114 Stat. 626 (2000), has already endorsed the use of governmentally supplied tax rate databases. The advantage of the Streamlined Sales Tax Project approach is that it achieves efficiency and simplification for interstate commerce, while allowing states and localities to tailor fiscal policy to fit local needs. It avoids, in particular, the problem of raising taxes in rural areas to finance services in urban areas that is inherent in requiring "one rate per state."

The latter portion of the question appears to raise the question whether Congress should require states to eliminate different state tax rates for different goods, such as lower rates on food or electricity than on other items. The states in the Streamlined Sales Tax Project chose wisely to develop a proposal for the phase-out of most of the differential state tax rates that apply to different items of personal property or services. Although current computer technology is sufficiently advanced to be able to assign different rates to different taxable items accurately, having one state rate for most taxable goods certainly is more easily administered. However, the states recognized that a simplified sales tax system could accommodate multiple rates for high value, durable goods such as motor vehicles, aircraft, watercraft, modular homes, manufactured homes and mobile homes—goods that are typically subject to either registration requirements or property taxation. Accordingly, the states did not adopt a phase-out for multiple rates on these enumerated items.

Should Congress reconsider the definition of Internet access, and if so, how would you propose defining Internet access?

If Congress extends the moratorium on state and local taxes on Internet access, it should re-evaluate the definition of Internet access within the moratorium to account for the increasing variety and extent of services that are "bundled" with access.

Since Congress wrote the original definition, changes in technology and corporate business structures have made it clear that it is now possible for large enterprises to bundle a broad array of otherwise taxable services with Internet access. The current definition appears to create the potential for discrimination in tax policy that would stifle competition and increase consumer costs, provide financial advantages to large enterprises, and erode state and local tax bases. Services delivered by large enterprises that can assemble the capital, technological, information and entertainment resources to bundle an array of services with Internet access would appear to be granted a tax exemption under the current language of the moratorium. The same services delivered through the Internet by smaller enterprises without the bundling capability or by non-electronic means would remain taxable. There is no economic or tax policy justification for Congress to create this disparity. Expanded bundling by large enterprises can substantially erode the tax bases of state and local governments that tax services.

The definition of Internet access should cover only access to the Internet. Because of the increasing problems in distinguishing between pure access and other services, Congress should explore a quantitative approach to defining access, such as was enacted by the State of Texas in the last few years.

The Commission has a neutral position on the question of whether or not Congress should extend a moratorium on state and local taxes of the Internet. We oppose removing, however, the "grandfather protection" in the Internet Tax Freedom Act for state and local governments levying taxes prior to the original moratorium as an unacceptable preemption of existing state and local tax policy.

Again, this list is not exhaustive. We welcome any and all comments. Our expectation is that the Commerce Committee will conduct a hearing on the Internet tax issue soon after we receive your policy recommendations.

The questions you raise in the letter of February 26, 2001, reflect a proper focus by the Senate Commerce Committee on sales and use taxes. The U.S. Supreme Court in its *Quill* decision invited Congress to address the issue of use tax collection by remote sellers. We are aware that some interests have sought to burden the sales and use tax issue with unrelated topics, especially the question of the authority of states to levy business activity taxes. Action by Congress to extend the authority of states to require the equitable collection of sales and use taxes will not result in a change in the authority of state and local governments to levy business activity taxes. Claims to the contrary are simply false.

The proposals advocated by some with regard to business activity taxes would dramatically change existing law. Typically the proposals would impose new restric-

tions on state authority in the form of physical activity standards of nexus for business activity taxes (including corporate income taxes, gross income or gross receipts taxes, and capital stock and franchise taxes). The imposition of these new standards would simply create and multiply within the business activity tax realm many of the problems that have existed in the context of sales and use taxes. Again, tax equity would suffer. Companies earning income from within a state and benefiting from state and local services would be excused from paying their fair share of the cost of those services. These proposals would elevate corporate form over economic substance and allow companies, through sophisticated tax strategies, to shift income unfairly away from where it was earned to tax haven locations. In terms of tax equity, the net result of the proposals would be to allow a select group of corporations to escape their fair share of state and local taxes and to shift that burden to wage-earners, small businesses and traditional manufacturing and natural resource industries—all of which are "captive" within the taxing state.

These proposals for new restrictions on state authority to levy business activity taxes would also detract from economic efficiency and balanced economic development by, again, discouraging the flow of investment across state boundaries. The physical activity approach to state authority is really an anachronism arising out of 17th and 18th century mercantilism. Centuries ago, the only way enterprises could earn income from a territory would be to undertake physical activities there. Today, companies can earn substantial income from a state—and in the process benefit from the services of a state—with only minimal activities that might traditionally be labeled "physical." To achieve tax neutrality—taxing the same income earned in the same state to the same degree—concepts of physical activity as a standard for state taxing authority need to be assigned to the dustbin of history. If companies can earn income from within a state, but escape taxation by keeping their activities within the boundaries of certain physical activities defined in a new federal law, then companies will be discouraged from going beyond those physical activities and making new and more substantial investments in that state. Thus, the proposals for new federal laws restricting state business activity taxes will only interfere with the free flow of commerce and balanced economic growth across the nation.

Thank you again for providing an opportunity for the Multistate Tax Commission to offer information and perspective on this important issue. The MTC would be glad to provide you with any further information or to answer any questions you may have. Please feel free to contact Dan Bucks, MTC Executive Director concerning these issues at 202–624–8699.

Sincerely,

ELIZABETH HARCHENKO,
Director, Oregon Department of Revenue,
Chairman, Multistate Tax Commission.

cc:
Hon. Ron Wyden, U.S. Senator
Hon. Byron Dorgan, U.S. Senator
Hon. George Voinovich, U.S. Senator
Hon. Mike Enzi, U.S. Senator
Hon. John Kerry, U.S. Senator

The CHAIRMAN. Thank you.

Mr. Dircksen, we will see if we can get in your statement before we take a break here.

STATEMENT OF JEFF DIRCKSEN, DIRECTOR OF CONGRESSIONAL ANALYSIS, NATIONAL TAXPAYERS UNION

Mr. DIRCKSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Take the microphone if you would, please.

Mr. DIRCKSEN. Mr. Chairman, Members of the Committee, I appreciate the opportunity to testify today on such a critical issue. I am the director of congressional analysis for the National Taxpayers' Union Foundation, the education and research arm of the National Taxpayers Union. NTU is America's oldest and largest grassroots taxpayers' organization, with over 300,000 members in all 50 states. I am here on behalf of NTU and its members to urge

you to extend the Internet tax moratorium, and to ensure that the Internet and online transactions remain tax-free.

Today, I want to briefly share three taxpayer concerns about increasing taxes on Internet usage and applying additional tax structures to Internet transactions. First, taxpayers are already burdened with heavy taxes, fees, and other charges on telecom services, and adding more would be headed in the wrong direction.

Second, concerns that essential government services will disappear because certain online transactions are not taxable are false.

Third, the imposition of taxes on Internet sales will make life for taxpayers and retailers far too complicated.

First, there are enough taxes and other fees on telecom services. Both the public and private sectors have benefited significantly from the deregulation of the telecom industry and from the productivity gains made possible by telecom products and the Internet, yet the National Conference of State Legislatures reported last February that state governments and local governments, nearly 11,000 of them, levy taxes or fees on telecommunications activities, including franchise taxes, utility taxes, line access, and right-of-way charges, 911 fees, relay charges, and maintenance surcharges.

As has been highlighted already, this past Monday, the NASDAQ composite index dipped below the 2000 point level for the first time since December 1998. The last thing that a slumping technology sector needs is higher taxes on the industry and on its consumers.

I must admit that I now have a personal stake in this issue. I found out on Sunday evening that my brother-in-law, who farms near Gann Valley, South Dakota, will be leaving agriculture to begin working for an ISP in Woonsocket, where my sister has been working for a mail order firm. The Internet touches the lives of people from all across the globe, including those on the Great Plains. Extending the Internet tax moratorium will help technology firms both large and small, including one in Woonsocket, South Dakota.

Rather than placing hurdles in front of telecom and e-commerce industries, Congress should consider instead reducing or eliminating barriers. Last year's attempt to repeal the phone excise tax was a good start, as mentioned by Senator Allen earlier.

Two, concern that essential government services will disappear are false. This scare tactic serves the interest of those who wish to raise taxes and extend government, yet the U.S. Department of Commerce reports that retail e-commerce sales in calendar year 2000 totaled $25.8 billion, or just 0.8 percent of all retail transactions. State government coffers are actually flush with cash.

The Nelson A. Rockefeller Institute of government reports that the growth in state tax revenues is at a record high. While states believe the information superhighway to be paved with gold, many online transactions such as online services or business-to-business transactions may not be subject to sales taxes in all states, resulting in far lower revenue gains than expected.

As Senator Wyden correctly observed, quote, not a single community has come forward and proved that it is being injured by its inability to impose discriminatory taxes on electronic commerce. There is no evidence that the states have lost revenues by tech-

nology-driven economic activities, and despite the argument to the contrary, where individuals go into retailers, kick the tires of the merchandise and then leave, most people I have talked with actually use the Internet to research available products and then go to their local retailer to buy.

Three, attempts to simplify and harmonize sales tax codes will make life far too complicated for taxpayers and retailers. The ensuing debate among the 7,500 entities that levy a sales tax will make past attempts by the European Union to define what constitutes marmalade, mayonnaise, or a cucumber seem like a pleasant tea party in comparison.

Variances in statutory definitions will force states to develop a new common definition for all goods available on the Internet, leading to questions about whether chocolate candies are a food, and whether they should be taxed as such. One hesitates to ponder the amount of time and taxpayer money that will be consumed in this endless wrangling. Taxpayers should be concerned that efforts to simplify and harmonize tax rates will run roughshod over the Supreme Court's 1992 Quill decision.

Once tax officials have simplified the system of Internet sales taxes, the next step is to impose the structure on mail order and phone orders, and then expand it to all retail purchases. This last step is the ultimate goal of NGA's simplification proposal. It is conceivable that under the simplified tax scheme Equal Protection and Commerce Clause concerns will arise, and local merchants will be required to collect and remit out-of-state sales taxes when selling goods across the counter to a customer from another state.

Additionally, we believe tax competition is a good thing. Before joining NTUF, I worked as a revenue analyst for the Commonwealth of Pennsylvania's Department of Revenue. The Commonwealth provides sales tax exemptions to people who purchase tangible personal property that is to be used in the production of feature-length films, as well as to bakers, horse breeders, and numerous others. Adopting this scheme to harmonize and simplify taxes will kill a state's competitive tax advantage, trample that state's sovereignty, remove incentives to keep taxes low, and hurt taxpayers in the process.

Should anyone actually believe this process will be either simple or easy, I would point out the difficulties that have been faced in revamping the Internal Revenue Service. By our account, the IRS has reorganized itself 29 times since 1952, and has spent billions of dollars on tax administration systems and computer networks that simply do not work. When you add the economic impact and the uncertainty that brings from Internet taxes, we believe that this dynamic sector should be left tax-free. The message cannot be more clear. Congress should declare this tax territory off-limits by extending the Internet tax moratorium and preventing states from imposing sales taxes on online transactions.

I thank the Committee, and I look forward to your questions.

[The prepared statement of Mr. Dircksen follows:]

PREPARED STATEMENT OF JEFF DIRCKSEN, DIRECTOR OF CONGRESSIONAL ANALYSIS, NATIONAL TAXPAYERS UNION

Mr. Chairman, Senator Hollings, Members of the Committee, I appreciate the opportunity to testify today on such a critical technological and economic issue facing America. I am the Director of Congressional Analysis for National Taxpayers Union Foundation, the education and research arm of the National Taxpayers Union (NTU). NTU is America's oldest and largest grassroots taxpayer organization with over 300,000 members in all 50 states. I am here on behalf of NTU and its membership to urge you to extend the Internet Tax Moratorium and to ensure that the Internet and online transactions remain tax-free.

Today, I want to share three taxpayer concerns about increasing taxes on Internet usage and applying additional tax structures to Internet transactions. First, taxpayers are already burdened with heavy taxes, fees, and other charges on telecommunications services, and adding more is moving in a counterproductive direction. Second, concerns that essential government services will disappear, because certain online transactions are not taxable, are false. Actually, state tax revenues are growing at a near record pace. Third, the imposition of taxes on Internet sales will make life for taxpayers and retailers far too complicated.

1. There are enough taxes, fees, and other charges on telecommunications services and adding more is heading in a counterproductive direction.

Cutting taxes, especially those levied on telecommunications and e-commerce activities, is beneficial to consumers. Both the public and private sectors have benefited significantly from the deregulation of the telecommunications industry and from the productivity gains made possible by telecom products and the Internet. Yet, the National Conference of State Legislatures reported last February that nearly 11,000 state and local governments levy taxes or fees on telecommunication activities, including franchise taxes, utility taxes, line access and right-of-way charges, 911 fees, relay charges, and maintenance surcharges.[1] A Federal Communications Commission survey of 95 metropolitan areas determined that the average tax rate levied by all governments on a phone bill was 15.7 percent. In Richmond, Virginia, the highest-taxing jurisdiction in the analysis, the rate approached 36 percent.

In early trading this past Monday, the Nasdaq Composite Index was down 2.9 percent, sinking below the 2,000-point level for the first time since December 16, 1998.[2] In the last twelve months, the Nasdaq has fallen nearly 60 percent. The last thing that a slumping technology sector needs is higher taxes on the industry and its consumers. In the interest of full disclosure, I must admit that I now have a personal stake in this issue. I learned late Sunday night that my brother-in-law who farms near Gann Valley, South Dakota, has decided to leave farming and will begin working for an ISP—which is probably not listed on the Nasdaq—in nearby Woonsocket, where my sister has been working for a mail order firm that sells duck decoys. The Internet touches the lives of people from all across the globe, including those on the Great Plains. Extending the Internet Moratorium will help technology firms, both large and small, including one in Woonsocket, South Dakota.

Rather than placing hurdles in front of the telecommunications and e-commerce industries, Congress should instead consider reducing or eliminating tax barriers. Last year's attempt to repeal the 103-year old telephone excise tax was a step in the right direction. NTU endorsed the Portman-Matsui bill, H.R. 3916, which the House passed 420 to 2 on May 25, 2000. Congress should move beyond the simple repeal of the 3 percent phone excise tax, and make the current moratorium on Internet taxes permanent, as well as establish the Internet as a tax-free zone for the sale of goods and services in perpetuity.

Moving in the wrong direction will have significant consequences. In 1998, economist Austan Goolsbee found that the number of online shoppers would fall by 25 percent, and the amount of dollars spent would plunge by 30 percent, if existing sales taxes were applied to Internet purchases.[3] Last year, a poll of 1,016 America Online subscribers found that two-thirds said "they'd be a lot or a little less likely to shop online if their purchases were subject to a uniform sales tax."[4] The Internet

---

[1] Scott Mackey, "Telecommunications and the Tangle of Taxes," *State Legislatures,* February 2000, http://www.ncsl.org/programs/pubs/200TELE.HTM.

[2] David Runk, "Nasdaq Drops 2.9 percent as Outlook Worries Drag Down Market," *The Wall Street Journal,* WSJ.com, March 12, 2001.

[3] Austan Goolsbee, "In a World Without Borders: The Impact of Taxes on Internet Commerce," National Bureau of Economic Research, *Working Paper No. W6863,* December 1998.

[4] David Muhlbaum, "AOL Members Say No New Net Taxes," CBS MarketWatch, March 20, 2000, http://netscape.marketwatch.com/source/blq/netscape/archive/20000320/news/current/cbsmwaol_poll.nsp.

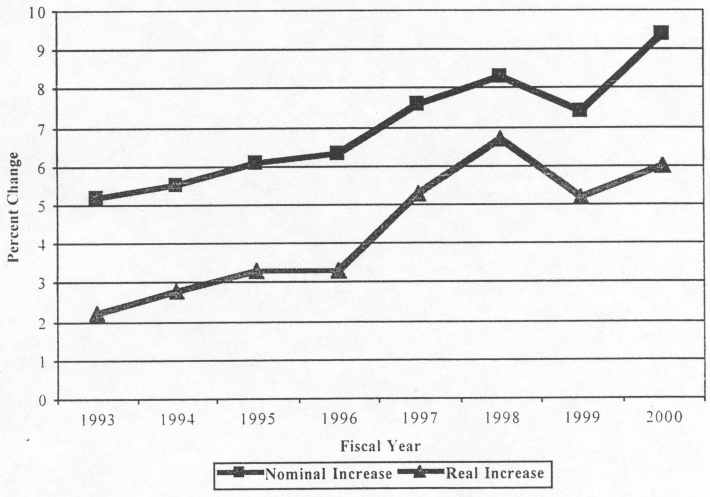
is a shopper's dream. In addition to offering just about every product imaginable, it allows consumers to compare prices, products, and providers quickly and easily with little out-of-pocket expense. Consumers no longer need to spend time driving from mall to mall looking for the best possible deal since the deals literally come to them—a definite benefit to those who may be homebound or may have difficulty traveling to shopping centers. Haggling is virtually eliminated because a better price is just a click away. Shackling the Internet with additional taxes will push many consumers offline, and for those who are able, back into their cars.

Any scheme that intends to simplify, streamline, or to make sales taxes "fairer" online is just one step away from trampling the Supreme Court's 1992 *Quill* ruling. Consumers should be wary of this backdoor attempt to run roughshod over the Court's restrictions on taxing phone and catalog sales. If such a system of extraterritorial collection is allowed, Congress will have opened the door to any number of potential tax cartels that will eventually harm rather than help taxpayers.

2. The argument that state revenue coffers will be devastated is bogus.

Despite assertions to the contrary, taxpayers are already chipping in more than their fair share, and state government coffers are flush with cash. According to The Nelson A. Rockefeller Institute of Government, state tax revenues grew 8.7 percent in Fiscal Year 2000. This represents the second largest year-over-year increase in the last decade, after adjusting for inflation.[5] Even when adjusting for the impact of legislated tax cuts, states have continued to see strong year-over-year revenue growth for the last eight fiscal years (See Figure 1).

Figure 1. Annual Nominal & Real Increases in State Tax Revenues, Adjusted for Tax Cuts



Source: The Nelson A. Rockefeller Institute of Government.

Those who support broadening the ability of states to collect sales taxes on remote retailers suggest that the potential rise in e-commerce will deprive states of billions of dollars in needed revenue and that essential government services will suddenly

[5] Nicholas W. Jenny and Elizabeth I. Davis, "Fiscal 2000 Tax Revenue Growth: Strongest of the Last Decade," *State Fiscal Brief,* No. 61, The Nelson A. Rockefeller Institute of Government, February 2001.

disappear.[6] This scare tactic serves the interests of those who wish to raise taxes and expand government, yet the Department of Commerce reports that retail e-commerce sales in calendar year 2000 totaled $25.8 billion, or just 0.8 percent of all retail sales.[7] While states believe the information super-highway to be paved with gold, it is important to remember that many online transactions, such as business-to-business sales and online services, would not be taxable in most states, resulting in far lower revenue gains than expected. In its report from last year, the General Accounting Office noted, "Little empirical data exist on the key factors needed to calculate the amount of sales and use tax revenues that state and local governments lose on Internet and other remote sales. What information does exist is often of unknown accuracy."[8] As Senator Wyden correctly observed when introducing the Internet Tax Nondiscrimination Act, "Not a single community has come forward and proved that it is being injured by its inability to impose discriminatory taxes on electronic commerce. There is no evidence that the states have lost revenue by technology-driven economic activity."[9]

3. Attempts to simplify and harmonize sales tax codes will make life far too complicated for taxpayers and retailers.

Any tax simplification scheme will require an extremely large table to ensure that everyone who has an interest in the discussion has a seat. If an agreement among the 46 states that impose a sales tax was all that was needed, the process might only be somewhat painful. However, there are an estimated 7,458 entities, including cities, counties, and other jurisdictions, that impose a sales tax (See Figure 2). Obtaining agreement among all jurisdictions would seem virtually impossible.

Figure 2. Number of Government Entities Imposing Sales & Use Taxes

Type of Jurisdiction	Number
States	46
Cities	4,696
Counties	1,602
Other Jurisdictions	1,113
Total	7,458

Source: Ernst & Young LLP.

The ensuing debate among these entities will make past attempts by the European Union to set standards for what constitutes "marmalade," "mayonnaise," or a "cucumber" seem like a pleasant tea party in comparison. Variances in statutory definitions will force states to develop a new common definition for all goods available on the Internet, leading to questions about whether chocolate candies are a food and should be taxed as such. Ironically, a press release from the National Governors Association (NGA) expresses their support for a simplified sales tax structure by highlighting the difficulties associated with taxing a marshmallow. NGA argues that the definitional differences across various states make it "very difficult for retailers to calculate, collect, and remit taxes on transactions that are done in multiple locations."[10] Actually, there is a very simple way to avoid this problem: do not let states trample on *Quill.* One hesitates to ponder the amount of time and tax-

[6] Andrew Caffrey, "States at Odds Over Web Taxes," *The Wall Street Journal,* March 7, 2001, p. B3.

[7] United States Department of Commerce, "Retail E-commerce Sales in Fourth Quarter 2000 Were $8.7 Billion, Up 67.1 Percent from Fourth Quarter 1999, Census Bureau Reports," Press Release, February 16, 2001, http://www.census.gov/mrts/www/current.html.

[8] United States General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain,* June 2000, p. 3.

[9] John Connor, "'Internet Tax Freedom' Bill Proposed in U.S. House, Senate," Dow Jones Newswires, February 8, 2001.

[10] National Governors Association, "Streamlined Sales Tax Project Gains Momentum," Press Release, March 8, 2001. http://www.nga.org/nga/newsRoom/1,1169,C__PRESS__RELEASE^D__1453,00.html

payer money that will be consumed by endless wrangling over definitions for candies and marshmallows.

Again, taxpayers should be wary of attempts to harmonize or simplify tax structures across state boundaries. Once tax officials have "simplified" the system for Internet sales, then the next step is to impose the structure on mail order sales, and then extend it to all retail purchases. This last step is the ultimate goal of NGA's simplification proposal. It is conceivable that under this simplified tax scheme, Equal Protection and Commerce Clause concerns will arise, and local merchants will be required to collect and remit out-of-state sales taxes when selling goods across the counter to customers from another state.[11] Creating more paperwork and headaches for all business owners is not our idea of making something simple.

Additionally, one must ask whether it is wise to end tax competition among states. The current sales tax structure allows states and localities to determine taxing priorities, allowing tax bases and rates to vary as legislative bodies see fit. Before joining NTUF, I worked as a Revenue Analyst for the Commonwealth of Pennsylvania's Department of Revenue, which like many states, has chosen to exempt certain activities or industries from sales and use taxes. For example, "Tangible personal properly used directly in the production of a feature-length commercial motion picture distributed to a national audience is exempt from taxation."[12] Why does the Commonwealth provide this exemption? It wants to encourage commercial films to be made in Pennsylvania. Via another exclusion, the Commonwealth exempts foundations for machinery and equipment in an attempt to prevent multiple taxation "which could occur in the production of a finished good for consumption."[13] The Commonwealth also provides sales tax exemptions for bakers and horse breeders, in addition to numerous others. NTU frequently receives letters and email messages from individuals who are considering relocating and want to find information on state and local tax burdens. These individuals see tax competition among states as extremely beneficial. Adopting a scheme to harmonize and simplify sales taxes structures would kill a state's competitive tax advantage, trample that state's sovereignty, remove incentives to keep taxes low, and hurt taxpayers in the process.

Even if a consensus agreement on what constitutes a marshmallow and how it should be treated under a simplified system does emerge, new software to track, collect, and remit revenues will be required. Should anyone believe that this process would be simple or smooth, I would point out the difficulties in revamping the Internal Revenue Service (IRS). By our count, the IRS has reorganized itself 29 times since 1952.[14] According to the Service's 1984 annual report, "Within the next five to ten years we will have a totally redesigned tax administration system. Paper tax returns can largely be a thing of the past."[15] Yet, in 1996, the IRS announced that after having spent more than $4 billion to modernize its computer systems that its efforts were "badly off track."[16] During my time as a Department of Revenue employee, the Department contracted with a private consulting firm to develop a Pennsylvania sales and use tax model to aid in forecasting tax collections. After nearly two years of development and testing the model, the Department was still not satisfied that the package could accurately model sales transactions in the Commonwealth. Writing software to address the collection and remittance needs of 7,500 governmental entities will be a programmer's nightmare and a potential taxpayer-funded boondoggle.

Add the uncertain economic impact that blanket Internet taxes could have on this dynamic sector, and the message to Congress could not be more clear. Congress should declare this tax territory "off limits" by extending the Internet Tax Moratorium and preventing states from imposing sales taxes on online transactions.

The CHAIRMAN. Thank you very much. We will take a break. We are not sure whether we have two votes or three votes, but we will be back as soon as possible to have questions for the panel, and we thank you for your patience. We will take a brief recess.

[Recess.]

---

[11] Adam D. Thierer, "The NGA's Misguided Plan to Tax the Internet and Create a New National Sales Tax," *The Heritage Foundation Backgrounder No. 1343,* February 4, 2000.

[12] *Governor's Executive Budget 2001–2002,* Commonwealth of Pennsylvania, p. D42.

[13] *Ibid.*

[14] Peter J. Sepp, "NTU Official Serves on IRS Reform Panel," *Dollars & Sense,* August 7, 1996, p. 4.

[15] Cited in Shelley L. Davis, *Unbridled Power* (HarperBusiness) 1997, p. 48.

[16] *Ibid.*

The CHAIRMAN. We will resume. Would the witnesses please regain their seats.

Mr. Julian, what costs should be considered in determining whether various modes of retail transactions are on a level playing field?

Mr. JULIAN. What costs should be considered? I think, Senator, it is the entirety of the cost of collection, which is not only the cost of the software, but the cost of employees in the company's tax department to file tax returns, the cost of companies involved in training their sales associates to deal with tax issues as they arise on the sales floor, or if it is a remote seller, to train their telephone operators and so forth, in the cost of administering the audits and litigation that follow from the tax collection.

The CHAIRMAN. Mr. Lowy, if it is so easy for mainline retailers to set up subsidiaries to avoid sales tax responsibilities, why is this option not their principle pursuit, rather than one of arguing for the states' abilities to broaden their sales tax collections?

Mr. LOWY. Well, if you look at it, Mr. Chairman, a number of the major retailers who have dot com subsidiaries were previously collecting sales taxes on some of those subsidiaries, and Wal-Mart, which is a member of ours, was one. They are now moving to a position where they are setting up their dot com subsidiaries and separate subsidiaries, the dot com retailers, and starting to go into the system of not collecting sales taxes.

The CHAIRMAN. Mr. Comfort, is it imperative that Congress act to extend the moratorium imposed by the Internet Tax Freedom Act before it expires in October?

Mr. COMFORT. Yes, sir, Mr. Chairman. Amazon.com would strongly endorse the extension or permanency of the moratorium.

The CHAIRMAN. Ms. Harchenko, what do you think of the proposal for one tax rate and one tax base per state for all types of commerce?

Ms. HARCHENKO. Mr. Chair, we believe that retailers should not have to figure out rates, but the work in the streamline sales tax project is designed to eliminate the need for retailers to figure that out by having the states provide them a database that will deal with those rate issues and if the retailers rely on the database they will be held harmless from any errors.

The CHAIRMAN. Mr. Dircksen, some of the state and local government officials argue that Internet sales will eventually force their sales tax systems to become obsolete, and inefficient for raising revenue for state and local governments. Besides your inherent opposition to taxes per se, what is your response to that?

Mr. DIRCKSEN. Thank you, Mr. Chairman. We would argue that primarily what you will see, the concern is, as the Governor said this morning, is balance, that you will see a dramatic shift, and there will be virtually ghost towns on Main Street and everyone will be purchasing online.

We do not believe that to be true. Primarily what we suspect will be that e-commerce sales, online transactions will replace most of the catalogue sales, and so states will be no worse off than they currently are.

The CHAIRMAN. Would you agree that we are in a, quote, worsening economy right now?

Mr. DIRCKSEN. I would, Mr. Chairman, yes.

The CHAIRMAN. That means that retail stales, in a worsening economy, none of us know whether it is a V or a U or an L, but would you agree that there will be a reduction in retail sales as part of this, at least temporarily, we all pray, temporarily worsening economy?

Mr. DIRCKSEN. That would seem most likely, yes.

The CHAIRMAN. And if I was a smart shopper and I had less money, and I went into Wal-Mart and I saw a piece of whatever it is I wanted to buy, and I knew that very close by there is a computer, would you not see an increase in this activity, coupled with the continuing forever increase in computer usage on the part of American citizens?

Mr. DIRCKSEN. That may be a possibility, and states can look into collecting use taxes. However, one thing to keep in mind is that there is an additional cost to most online transactions, in terms of, you may not pay direct sales tax, but few companies deliver it to your door without charging you shipping and freight, so the difference between sales tax and your total bill when you include shipping may be extremely negligible, so that it really does not affect or distort customer behavior that significantly.

The CHAIRMAN. Mr. Lowy, I am on vacation in California, which a lot of my constituents have a habit of doing in the summer, given the mild climate in Arizona in the months of June, July, and August, but I still maintain my residence in the State of Arizona, so I get on the Internet and I order something over the Internet from L. L. Bean, which is delivered to me in California. What is the tax situation there?

Mr. LOWY. Well, if you order it over the Internet, obviously you use a credit card to pay for it. That credit card will have a billing address, and if that billing address is your home address in Arizona, then they should charge you Arizona use taxes for that purchase.

The CHAIRMAN. Then why have we had so much trouble with catalogues, with mail order catalogues?

Mr. LOWY. I think the issue, when you look at it, is that before the states had started going into the simplification process, the argument of complexity was a very legitimate argument to use at the time, but as with the states moving to their simplification process, if you simplify the system, and then you use the technology that is in place today, that the burden on the retailers, both online and physical retailers can be lessened substantially so that the burden will be, not zero, but almost de minimis for them to be able to collect those sales and use taxes.

The CHAIRMAN. Mr. Comfort, do you have a different view?

Mr. COMFORT. Senator, I do not know that I have a different view of the general statement, but we have a concern about what it means to achieve simplification.

I would also suggest that the use of the billing address raises other concerns that Members of the Committee have expressed about creating Cayman Islands problems. It is not terribly difficult to get a credit card with a billing address at a post office box in the Cayman Islands, so I am not sure that the billing address would be the right way to go. I think a five-digit zip code for the

shipping address might be the better way, if you were going to do it.

Our concern is that we not be put in the position of having to deal with the same regime under a new name, be it streamlined, or simplified, or whatever, and that Congress clearly establish the criteria it needs before the approval for remote sales collections is provided.

The CHAIRMAN. Well, I want to apologize to the panel for having to leave. I will, however, turn you over to the tender mercies of Senator Dorgan, who is the—perhaps the single most knowledgeable—he and Senator Wyden and Senator Kerry are the most knowledgeable on this issue.

I want to thank you for your patience today. I want to thank you for your testimony, and as I mentioned earlier there are two major issues that face this Committee and this Congress on the Internet, and both are very difficult. One is Internet tax and the other is Internet privacy, and we thank you for your contributions and continued communications with us as we work our way through this particular issue.

Senator Dorgan.

Senator DORGAN. Mr. Chairman, thank you very much. I will ask questions and then adjourn the hearing, and let me again thank you for the courtesy of having the hearing.

Mr. Lowy, some witnesses have said that this issue of fairness is really pretty irrelevant, and the issue of the impact on brick-and-mortar sellers is irrelevant. Characterizing their argument, there is really nothing happening here. There are not lost sales. In fact, people are shopping on the Internet and then going and buying in brick-and-mortar stores.

Mr. Comfort I am sure was gritting his teeth when he heard that statement, but nonetheless, people are saying that this is all—this fairness and lost sales, this is all a mirage.

Can you respond to that?

Mr. LOWY. Yes. I think if you look at the issue, we have never come into the argument saying that the brick-and-mortar retailers are going to be devastated by the online retailers. What we did say is that the online retailers compete with brick-and-mortar retailers, and that competition is unfairly influenced by the lack of collection of sales taxes over Internet sales.

But I think if you look at where the business model has gone today, I think the arguments and the discussion needs to change, because with the advent of the dot com subsidiary, and the ability to avoid nexus by having a physical retailer who has an online store actually have a screen in their store, with the ability to bypass the sales tax system, creates issues that need to be dealt with.

Senator DORGAN. Ms. Harchenko, your state does not have a sales tax, and so some would say you really probably have less at stake as a state. However, you are chairman of the Multistate Tax Commission, and I know you speak for a number of states, and the interests of a number of states on tax enforcement issues.

The suggestion has been made by Mr. Julian that there needs to be dramatic simplification, and if we move down this road, and I frankly have some sympathy with that. I think it was Mr. Comfort, in discussions we had previously, who said to me—or his staff, one

or the two, said to me that in one zip code in Colorado there are five separate sales tax rates, in one zip code. Now, that is complexity, so we do not want someone mailing a product into that zip code as a part of a remote sale to have to try to figure out which one of the five rates do I apply, and if they make the wrong decision, be held accountable for it.

Do you generally agree that there needs to be substantial simplification here if the Congress is going to proceed to allow the states to force a collection on use taxes?

Ms. HARCHENKO. Yes, Senator, and that is one of the objectives of the streamline sales tax project, is to be able to provide a database so that the retailer does not have to sort their way through it.

We have precedent that the Congress has already enacted in the Mobile Telecommunications Sourcing Act, whereby the states agree to provide databases to the industry so that industry people do not have to be concerned about guessing and guessing wrong, and that is one of the fundamental objectives of the streamline project as well, is to take that risk of not knowing away from the retailers, put it on the states, and hold the retailers harmless if they use the state database.

Senator DORGAN. You notice that in the legislation my colleagues and I have introduced we have a study dealing with the issue of compensation to retailers, not just remote sellers, especially remote sellers, but all sellers. How do you feel about that?

Ms. HARCHENKO. Senator, the Multistate Tax Commission voted at a recent meeting to engage and financially report such a study, so we are ready to be full participants.

Senator DORGAN. I think it is fair. I mean, there clearly are compliance issues. There are costs that businesses have, and it is one of the reasons we have a de minimis in the legislation I have introduced. I do not want someone who starts up and is only selling a couple of hundred thousand dollars worth of goods to be confronted with the requirement to comply with a wide range of tax authorities.

But in any event, I just wanted to make the point that the work the Multistate Tax Commission does is good work. I appreciate their leadership, but I want you to know that as a supporter of your work I also feel strongly that if the Congress is going to do something that extends their reach with respect to the collection of use taxes upon remote sellers, then we must require simplification, real simplification, not simplification in name, but real simplification. In my judgment, that is a requirement.

Mr. Dircksen, you testified that the technology sector is weak, and I agree that is the case. Would that have altered your testimony, however? I mean, would you, a year-and-a-half ago when the technology sector was strong, have said anything that is at odds with what you have just described today?

Mr. DIRCKSEN. Not likely, Senator.

Senator DORGAN. That is just an observation?

Mr. DIRCKSEN. It is an observation. It is a concern, though, that a struggling technology sector that is based on business-to-business transactions, or business-to-consumer retail transactions, needs not

to be shackled with additional taxes, or additional requirements such as the Internet.

Senator DORGAN. In your statement you did something similar to the Lieutenant Governor of Massachusetts. I again want to make sure you understand, the issue is not about any new taxes. There is nothing that was discussed here today that represents a new tax. A tax exists on the transaction. Do you agree with that?

Mr. DIRCKSEN. That is correct, Senator. That is true, and it is up to states to collect and enforce their own use tax, and if they decide not to enforce that, then we do not believe it is appropriate for states to come to the Federal Government and say, force us, or force our taxpayers to pay us what they owe us. It should be up to the states.

Senator DORGAN. Do you believe those use—well, states, actually no state that I am aware of—I would ask you, I guess. Are you aware of a state that has decided not to enforce their use tax? No state that I am aware of has made that decision.

Mr. DIRCKSEN. I do not believe any state that has a use tax on the books has repealed a use tax.

Senator DORGAN. But are you aware of any that have decided they will not enforce it?

Mr. DIRCKSEN. Other than South Dakota, where Governor Janklow has suggested stopping all the UPS trucks coming into the state and examining them for possible use tax collections, I do not know that any state really makes a significant effort to really track down use tax collections.

Senator DORGAN. Right, and the point I am making is they have not made an affirmative decision not to collect use taxes. The reason use taxes are not collected is because it is impossible to collect use taxes against millions and millions of purchasers on individual purchases.

I will not ask you whether you have shopped on the Internet and whether you filed a use tax report with a state.

Mr. DIRCKSEN. Thank you, Senator. I appreciate that.

[Laughter.]

Mr. DIRCKSEN. But I would point out in terms of fairness and simplification, you know, the concern is, again, from when I was with the Commonwealth of Pennsylvania, when is a phone tax calling card taxable and when is it not taxable? For the Commonwealth of Pennsylvania, phone tax cards are not subject to sales tax, except when maybe they are a collectible item because all the taxes are based into your using the minutes on the card, but if it has Michael Jordan on the cover, and you may never open the package, and you may never use the time, and you may never pay the taxes, well then, should that item be subject to sales tax?

These are the types of discussion that go on within state government about, well, how do you define what is taxable, what is not taxable, and the idea that, well, we need to streamline and simplify and get all taxing jurisdictions to agree to a common standard, I think is going to be extremely difficult, and will represent burdens for both taxpayers and for businesses.

Senator DORGAN. I agree if you go over to the edge and start spending all of your day defining the edge issues, you can have that kind of discussion, but if you go to the middle and describe

the purchase of something that is more common, and which is taxed in every jurisdiction, and which the application of the tax is pretty straightforward, you will not have that kind of discussion, but the point is, to the extent that we move in this direction, we should require simplification.

Mr. Julian, your testimony sort of straddles both sides of this issue, and I thought it was interesting testimony. You are representing a corporation that I assume does business as a brick-and-mortar seller and also does business with respect to remote sales, is that correct?

Mr. JULIAN. The vast majority of business, Senator, is brick-and-mortar department stores, but we do have a growing direct-to-consumer business. In terms of, to address the issue of competitive advantage, we were one of the first companies to have a catalogue subsidiary with Bloomingdales by Mail, and back in the eighties, states were aggressively going after the catalogue subsidiaries to try to require them to collect tax.

At that point in time, our business belief was that it was best for that Bloomingdales by Mail subsidiary not to have to collect tax, so we structured that business in a very precise manner so that we did things that would not create nexus in other states.

We spent literally over $1 million litigating that issue in states that came after us. We succeeded in the litigation. The supreme courts of two states ruled that we did not have nexus and therefore were not required to collect tax in those states.

As time went on, from a business standpoint our management wanted to do some things like put the catalogues in stores, things that would have created nexus. They were concerned about the effect that would have on the sales of the Bloomingdale's by Mail subsidiary, so we did it, we put the catalogues in the stores, we registered to collect tax in every state where there is a Bloomingdale's store.

We looked at it very closely, and we were surprised on two accounts. Number one, we thought that we would see a decrease in sales because we were now collecting tax in those states. We did not see that decrease in sales, but the bigger surprise was, we grossly underestimated the cost of collecting the tax in those states, and there we are only talking 10 states.

Senator DORGAN. And that is the point that Mr. Comfort, testifying on behalf of Amazon and others make, and I think it is a fair point.

Mr. Comfort, I happen to be a customer, and I like the one click, and you know, there is a convenience. I also shop at bookstores and other outlets that sell the merchandise you sell, but I shop online as well, and I recognize that your testimony, your company's representation, at least to me, has been you do not object to being required to collect taxes that are owed on a transaction, but you do not want to be in a position as a company of having to deal with thousands and thousands of different jurisdictions that have a different base, different rates, in some circumstances multiple rates where you really cannot determine exactly what rate should be applied, and you want to be held harmless in circumstances where you have that uncertainty.

I agree with all of that. I understand all of that, and I think your position is a very responsible position for the company to take, and I believe very strongly that we will reach some kind of an agreement on this Committee. I do not know exactly where it goes from there, but we will reach an agreement by which the extension of the moratorium, which I support, which prohibits taxing access, prohibits punitive and discriminatory taxes, will be accompanied by a mechanism that mandates and requires a simplification process that is real, number 1, and then number 2, the requirement for collection of taxes that are already owed as a result of that simplification.

I want to make one additional point, because I do not know that it has been made here this morning. The streamlining process I think is encouraging. I think states are moving in a way that is encouraging, Ms. Harchenko, but I also must tell you that there are some discouraging signs from time to time.

There are groups and local governments who say, do not tread on me, do not do anything that will make me uncomfortable, and so you have got five or six different organizations and groups representing local governments—I will not mention them all, but having different positions on simplification.

That cannot be the case. Ultimately they are all going to have to come to the same conclusion. All the spotlights are going to have to shine on the same spot with respect to simplification, and not everyone is going to get what they want with respect to local governments, and I am a big supporter of the local prerogatives of state and local governments, but I am also going to insist as we proceed here that we proceed in a way that requires fairness, and requires also simplification. Those are twins that must move together.

So I wanted to say that there is a lot of misinformation about this, the issue of new tax and all of these issues. The one piece of misinformation that I think existed at this hearing again today and traditionally exists is the Supreme Court has ruled a certain way and what Congress is trying to do is overturn the Supreme Court ruling. In fact, that has been said again today.

That is fundamentally wrong. It is unsound and in my judgment uninformed reading of the Supreme Court decision. The Commerce Clause gives Congress, and only the Congress, the opportunity to say to the courts, or say to the states, rather, here is the basis on which you are able to describe nexus. Only the Congress can give that opportunity to the states.

Now, some state and local folks will disagree with me. They believe the courts have said that they do certain things, mind their manners, and make their changes, that they eventually will be able to get through that door by themselves. I do not think there is a chance of that happening. I disagree with them. But Congress does have the requirement, if it chooses, to say to the states, here is how we describe nexus for you.

So that is what the Supreme Court issue was. It is not overturning the Supreme Court. It is simply saying to the states, this is not your prerogative. It is the prerogative of the U.S. Congress and only the U.S. Congress. That is why we have a hearing, that is why we have legislation.

Your testimony is very important to us, those who support and those oppose these issues. It is very important to get a full record established, and the chairman and I and Senator Wyden and Senator Kerry and others have been meeting, and we will meet some more as a result of this hearing, and I do remain hopeful that we will find a way to solve several issues, 1) simplicity. I do not want in any way to injure those who are involved in Internet commerce. I think it is a wonderful new way to extend and to provide outreach and give the American people new opportunities.

I also do not want in any way to have a tax system that is unfair to Main Street. A lot of mom and pops across this country have risked their all and have their entire investment in their business, and there is enough of a Jeffersonian Democrat in me to believe that broadbased economic ownership in this country still represents the hallmark of both economic freedom and political freedom, and so I want to be sure that we are fair to Main Street businesses.

Then I want to be sure that we are fair to the states to have an opportunity to collect the revenues that are owed, to be able to support state and local education initiatives that are very important to me.

So with that, let me thank all of you very much. Your testimony was very informed and interesting, and this hearing is adjourned.

[Whereupon, at 12 noon the Committee adjourned.]

APPENDIX

PREPARED STATEMENT OF ARTHUR R. ROSEN ON BEHALF OF THE COALITION FOR RATIONAL AND FAIR TAXATION

Thank you for this opportunity to address certain issues of state taxation that have reached critical importance due to the expansion of electronic commerce. I am Arthur Rosen and am a member of the international law firm of McDermott, Will & Emery. I respectfully submit this testimony on behalf of the Coalition for Rational and Fair Taxation ("CRAFT"), a diverse coalition of some of America's major corporations involved in interstate commerce, including Internet companies such as Cisco, Microsoft, and America Online; broadcasters such as ABC/Disney and CBS/Viacom, electronics manufacturers such as Sony Corporation of America, interstate retailers such as J. Crew Group and Sara Lee Corporation, publishers, financial services businesses, and other major businesses engaged in interstate commerce, such as Eastman Kodak. Many of my partners and I at McDermott, Will & Emery have been deeply involved in many of the relevant state tax issues, having successfully represented the taxpayer in such landmark Supreme Court cases as *Quill, ASARCO,* and *Woolworth.*

CRAFT urges that you not attempt to address Internet-related taxation issues without establishing national standards for when a state or locality can impose business activity taxes, such as income and franchise taxes, on businesses located in other states.

One of the principal recommendations of the Advisory Commission on Electronic Commerce majority report was that business activity tax nexus issues be addressed, along with the moratorium on Internet access taxes and sales tax simplification. We applaud Senator Gregg and Senator Kohl for their leadership in this effort, by introducing the New Economy Tax Simplification Act last Congress. We understand that they plan to re-introduce similar legislation shortly. We strongly urge the Members of this Committee to consider their legislation before acting in this area.

Constitutional Framework

The principal motivation for our adoption of the Constitution to replace the Articles of Confederation was a desire to establish and ensure the maintenance of a single, integrated, robust American economy. This is reflected in the Commerce Clause, which, as you know, provides Congress with the authority—and the responsibility—to safeguard this principle. Perhaps the hallmark of American federalism is this assignment to the Federal Government (along with responsibility for foreign affairs and the national monetary/fiscal system). Accordingly, legislation regarding imposing, regulating, or removing tax burdens placed on transactions in interstate commerce is not only within Congress' realm of authority, it is also Congress' responsibility. Thus, there is absolutely no validity to the argument raised by some state and local tax officials to the effect that Congress should abdicate its responsibility and leave these issues to the states. Those who claim that congressional activity in this area violates the principles of federalism are simply wrong.

As a second point in the context of the fundamental principles to be considered, it is important to remember that while Congress has Constitutional authority and responsibility under the Commerce Clause, it may be constrained by the confines of the Fourteenth Amendment's Due Process Clause. While it is far from clear, most commentators believe that Congress cannot permit states to violate the protections afforded by that clause. In the context of state taxation, the Supreme Court has determined that Due Process means that "the simple but controlling question is whether the state has given anything for which it can ask return. " *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435 (1940).

Policy Concerns

Turning to the overarching, fundamental, crucial policy issues, there is one that I believe warrants substantial, focused congressional consideration.

This policy issue relates to business activity taxes. There has been a great amount of discussion and publicity regarding sales and use tax nexus issues. These, how-

ever, are merely "the tip of the iceberg. " While collecting tax from customers and remitting it to governmental units pursuant to numerous inconsistent laws is quite a burden, it pales in comparison to the immense burden that is faced by a remote seller that must compute and pay income, franchise and license taxes to every jurisdiction where it has a customer. Such a situation not only causes huge administrative burdens as with the sales tax, but also imposes true, substantial economic hardship for interstate businesses.

As background, it should be noted that states, like governments worldwide, have traditionally imposed their corporate income and/or franchise taxes ("business activity taxes") only upon businesses that receive governmental benefits and protections afforded by the jurisdiction. This has meant that businesses maintaining offices, inventory, employees or agents in a state would be subject to business activity taxes in return for the benefits and protections afforded by the taxing state to the businesses' people and their property. Corporations could develop and carry on interstate business knowing that only their activities and presence in a state would incur a business activity tax liability, fostering a business environment without artificial market barriers that would retard economic growth.

Over 40 years ago, Congress passed legislation to ensure that states could not tax the income of out-of-state corporations whose in-state presence was minimal. Public Law 86–272 set uniform, national standards for when states could and could not impose such taxes. However, like the economy of the time, Public Law 86–272 was directed at sales of tangible personal property.

Recently, however, a large number of states have been alarmingly aggressive and "creative" in attempting to expand the reach of their business activity taxes to burden those businesses that are not provided with any measurable governmental protections or benefits by the taxing state. These states are seeking to tax the income of out-of-state corporations carrying on virtually no income-producing activity in those jurisdictions, for activities involving intangible property and services.

For example, these efforts have resulted in the imposition of business activity taxes by several states on out-of-state corporations that merely licensed trademarks to another corporation for use in the state, but itself carried on no activity and had no tangible property or personnel there. Another state attempted to impose business activity taxes on an out-of-state bank issuing credit cards to residents based largely upon the possession of the plastic credit cards by the state's residents. In yet another instance, a state Comptroller attempted to impose the state franchise tax upon a company whose only contact with the state was its possession of a certificate of authority to do business within the state. In other instances, states have attempted to impose business activity taxes when corporations merely have held passive investments in operating businesses, owned accounts receivable payable by residents, and performed services for residents even though the services were performed in another jurisdiction.

In this period where the rapid growth of e-commerce will shape the economy of the 21st century, these efforts by states to expand their taxing jurisdiction to cover activities conducted in other jurisdictions will constitute an even greater burden on the business community's ability to carry on business. Left unchecked, this expansion of the states' power to impose business activity taxes will have a chilling effect on the entire economy as tax burdens, compliance costs, litigation, and uncertainty escalate.

Consequently, a large portion of the business community is asking Congress to consider when state and local governments should and should not be permitted to require out-of-state businesses to pay income and/or franchise tax ("business activity taxes"). It appears eminently fair and reasonable for Congress to provide relief from unfair and unreasonable imposition of income and franchise taxes on out-of-state businesses that have little or no physical connection with the state or locality.

The time has come to update Public Law 86–272 for the digital age. Ours has become a more service-oriented economy, and intangible property such as intellectual property now plays a much greater role in our economic output. Public Law 86–272 must be modernized to include coverage of services and intangible property, and other refinements.

The report of the majority of the Advisory Commission on Electronic Commerce agreed with the importance of accomplishing this goal. Those suggestions, if augmented by certain additional items that are set forth below, would establish a clear, understandable, administerable demarcation of taxation that is extremely less restrictive on the governments than the "permanent establishment" rule that the United States and most other countries have imposed on themselves in the context of international tax treaties.

We strongly urge Congress to adopt the Advisory Commission on Electronic Commerce's recommendation, and further suggest that Congress consider adding provi-

sions that would permit states and localities to impose tax only on companies that have either or both of the following types of presence in the taxing jurisdiction during the taxable year:

- Leasing or owning substantial tangible property in the jurisdiction for more than 30 days.

  For purposes of this 30-day property rule, property in the taxing jurisdiction for purposes of being assembled, manufactured, processed, or tested by in-jurisdiction persons for the benefit of the owner or lessee, or used to furnish a service by in-jurisdiction persons to the owner or lessee, would be disregarded.

- Any number of employees or actual agents in the taxing jurisdiction for more than 30 days.

  For purposes of this 30-day employee rule, presence of employees for purposes of purchasing goods or services, gathering news and covering events, meeting with government officials, attending conferences, seminars and similar functions, and participating in charitable activities would be disregarded. In addition, solicitation activities would be disregarded, as they are under current law.

It would appear that these business activity tax provisions warrant your support because:

- States have, in recent years, sought to expand their imposition of business activity taxes in an apparent challenge to generally understood Constitutional principles. Permitting such expansion would dampen business innovation and expansion, thus bringing harm to the American economy. The imposition of new, expanded tax liabilities on the business community would seriously undermine the ability of the U. S. economy to remain robust. Removing this contentious thorn from the American business community can only be beneficial to the economy.

- When a company's presence in a state is minimal, it is not deriving material or meaningful protections or benefits from that state. The fact that a business may have customers in a state, or is itself a customer in a state, is a benefit to in-state persons who are already subject to tax. To assert, as some state officials have, that sellers reap an economic benefit from market states and thus should pay taxes there, flies in the face of an extremely elementary economic principle. That principle recognizes that a buyer in any market situation is, in his or her or its value system, obtaining more than is being given. Someone buys an item for $3 because the item is worth more than retaining the $3; the seller believes that the $3 is more valuable than the item. While this may sound somewhat academic and theoretical, it is how we all actually operate. Consequently, the seller is no more "taking advantage of" the buyer and the market state than the buyer is "taking advantage of" the seller and the production state.

- This proposal would have a *de minimis* fiscal effect. This is because state and local governments are currently collecting very little through their relatively new, but aggressive, attempts at expanding their tax jurisdiction over business activity taxes. All major attempts by states at doing so are currently the subject of intensive litigation.

These changes will remove impediments to the growth of e-commerce and interstate commerce generally, provide certainty to states and businesses and reduce wasteful litigation, and ensure that states which provide services to in-state businesses receive the income tax revenue which should rightly go to them. We look forward to working with the Committee to achieve these goals.

PREPARED STATEMENT FOR THE RECORD BY THE
ELECTRONIC COMMERCE ASSOCIATION

In assessing and guiding the states' effort to simplify their sales tax systems, it is important to recognize what is possible and efficient for technology to accomplish, on the one hand, and for the states to accomplish, on the other. For instance, it is tempting to define simplification by the standard of one tax rate per state, and to compel states to meet that standard. Yet overcoming the political hurdles of achieving one rate per state would be more difficult than overcoming the technological hurdles of calculating varying tax rates in a simple and cost effective manner. Com-

panies that create software to calculate sales taxes in various states soon will demonstrate that they have overcome the technological hurdles.

That does not mean that state governments can or should let technology do all the work. The states need to agree on certain standards to avoid burdening merchants and the technology that they use. Participating states should simplify and standardize their sales tax systems by implementing the following:

- uniform product definitions
- simplified exemptions procedures for retailers
- uniform, electronic tax filing forms
- standard format for remittances
- statewide audits
- uniform rounding rules
- a central database for tax rates of all jurisdictions, which each state will maintain
- uniform and electronic registration for out-of-state retailers
- restrictions on frequency of rate changes and common start dates for changes
- elimination of or limitation on caps and thresholds for imposition of tax on certain items

The recommendations of the Streamlined Sales Tax Project incorporated most of these simplifications.

The Electronic Commerce Association represents service providers for online merchants. The ECA has a task force composed of payment processing companies and other companies providing services to online merchants. The task force advises state organizations about potential problems they need to address in streamlining their sales tax system.

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

Thank you for this opportunity to offer my testimony. I offer this testimony on behalf of our individual members, our network of over 3,000 state and local taxpayer groups nationally and taxpayers in general. As you may know, I was one of 19 members of the Advisory Commission on Electronic Commerce. This Commission was authorized by Congress to study federal, state, local and international taxation and tariffs on transactions using the Internet and Internet access. Our goal as appointed Commissioners was to bring each of our unique views and experiences to the table, to learn how other industries, representatives and groups utilize the Internet and the issues surrounding interstate commerce. These issues included the barriers to growing and cultivating this new marketplace and ways to eliminate these barriers. Policy proposals from the Commission to Congress required a two-thirds majority.

Our discussions during this Commission are of merit now because we had before us the same questions you have before your Committee. Should the Internet be taxed? What should the Congress do in order to make taxing the Internet, and taxing sales over the Internet, easier or more difficult? Is there a role? Should taxing be easier? Can taxing possibly get more complicated? These are the questions I would like to respond to today.

Others represent their company industry perspectives, and by extension what effects changes of law will have on them and how they will pass this on to consumers. For instance, the 3 percent federal luxury tax on telephone service—which is no longer a luxury—is passed directly through to the taxpayer. Telephone companies add an additional line item onto telephone bills, and while these companies shoulder the burden of charging and collecting these fees, it falls to working Americans to pay the tax. Telephone companies expend resources having to collect these fees, but on behalf of the taxpayer, I believe the bigger issue is that this is a tax, and every American will realize the benefit when Congress again votes to repeal it. I look forward to that vote again this year.

Today, as a representative of the taxpayer I'm speaking against an additional tax on Americans. Extending unfettered state and local sales taxes to the Internet is a tax. This Committee is entertaining ways to take more money out of the pockets of hard working Americans rather than finding ways to return it, in light of the growing surplus.

The Federal Government is not the only governmental entity with a surplus. The states that will come before you and demand federal intervention in their laws so that they may add more money to their growing budgets also have surpluses. In addition, because most e-commerce is business-to-business or other exempt products not subject to sales taxes, the actual "loss" to state and local sales tax collection was one percent of sales taxes collected in 2000. There is certainly no shortage of tax revenues entering the budgets of the government on any level. And yet we're discussing a tax increase. We should not be taxing Americans again.

Furthermore, not only do state and local governments want to add additional taxes onto working Americans, they want Congress to devise a plan for them to implement it. Congress would in effect be the proponent of this additional tax. Local governments, storefront associations and tax commissioners have not been able to develop a plan they all can agree on, so they are now asking Congress to formulate it for them. Congress should resist these efforts and instead retain its sole ability to regulate interstate commerce as provided under the Constitution. State and local governments should not tax Internet transactions.

The Internet's most fascinating effect on America has been the nationwide marketplace that has developed. It is interstate commerce on a scale never imagined. The Internet and taxes placed upon this marketplace are directly within the realm of Congress and the Commerce Committee specifically. The Congress should monitor the system and ensure that no goods or services are unfairly taxed or discriminated against, in order to ensure regulatory certainty for new innovation and growth.

Rather than implement an additional sales tax over the Internet, Congress should focus on the regulatory burden on sellers over the Internet. They are required to know the unique sales tax laws in each state and local jurisdiction that levies a tax and how to file and remit taxes to each of those jurisdictions. According to the Congressional Research Services, forty-five states and the District of Columbia have some type of sales tax. Additionally, of the 30,000 local jurisdictions that can levy taxes, approximately 25 percent have done so.

In addition to simplifying sales taxes, Congress should demand that states simplify their business compliance taxes (e.g., income, gross receipts, and franchise taxes). In many cases, the myriad taxes placed upon telecommunications companies and the companies that supply the Internet backbone are discriminatory in nature. For instance, property taxes placed upon a neighboring business should be the same as those on telecommunications carriers. Sales taxes on phone bills should be no higher than the local sales tax. Gross receipts taxes should also not be taxed higher, or more often, than any other business in the state. As was provided for railroads, airlines, and trucking companies, telecommunications carriers who provide the backbone for interstate commerce should also not have discriminatory tax burdens.

Finally, Congress ought to look at the definition of nexus. Defining this word in the new Internet marketplace would help alleviate the bureaucratic burden that some companies suffer under, especially those who only have a server or other computer equipment in certain areas, but nothing that under common sense definitions could be construed as "nexus." Last Congress Senator Judd Gregg introduced a bill to this effect that could serve as a starting point for discussion this Congress.

Contrary to what some tax hungry politicians will try to tell you, the Internet is not a threat to Main Street bricks-and-mortar businesses. It is a tremendous opportunity. The Internet allows businesses to offer more choices to a larger number of consumers than ever before. It also offers rural customers convenience and a broader selection.

The Internet economy accounts for nearly one-third of our nation's economic growth. As recent stock market fluctuations have amply demonstrated, government intervention in the high-tech marketplace creates fear and uncertainty among investors. We must stop tax hungry politicians from concocting a scheme to tax to death the goose that laid the golden egg and destroying our high-tech economy.

As we enter the 21st century we have the opportunity and the ability to give consumers the full benefits of high technology without harming Main Street or state governments. The Advisory Commission on Electronic Commerce has pointed us in that direction, but we must all to our part to make sure that the Internet will remain free from the heavy hand of government taxation.

Again, thank you for this opportunity.

Massachussetts High Technology Council

Hon. JOHN MCCAIN,
Chairman,
Committee on Commerce, Science, and Technology,
U.S. Senate,
Washington, DC.

Dear Senator McCain:

In 1997, the Massachusetts High Technology Council strongly supported passage of the Internet Tax Freedom Act. Today, the High Tech Council supports keeping the Internet as a tax-free zone in order to allow the growth of a high potential growth industry that has experienced setbacks in recent months. Therefore, we join Massachusetts Lt. Governor Jane Swift in urging Congress to extend the federal Internet tax moratorium set to expire this year.

The Massachusetts High Technology Council is a non-profit, non-partisan corporation made up of 200 entrepreneurial and respected chief executive officers of Massachusetts high technology companies employing more than 200,000 people. Its goal is to help make Massachusetts the world's most attractive place in which to live and work, and in which to create, operate and expand high technology businesses.

It is essential that the Net not be tangled in a web of taxation. This is especially important to allow for the growth of an industry still in its infancy. Imposing taxes on the Internet, whether by the Federal Government or any of the 30,000 taxing jurisdictions around the country, would have grave consequences for many high tech employers in Massachusetts and across the nation.

The High Tech Council also opposes a nationwide sales tax collection system, offered under the guise of "tax simplification," because of its potential negative impact on businesses and consumers. Not only will it increase the costs of goods for consumers and prove a logistical nightmare for businesses (particularly small companies), the plan proposed by the National Governors Association would create another massive, intrusive tax collecting bureaucracy. As Lt. Governor Swift said in her testimony, "One IRS is enough for Washington."

Thank you for your consideration of this matter of the utmost importance to the nation's economy.

Sincerely,

CHRISTOPHER ANDERSON,
President.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO HON. JIM GERINGER

Question 1. Governor Geringer, your testimony says that "the states have already begun to cooperate to simplify state and local tax systems." I assume you are referring to the efforts of the Streamlined Sales Tax Project, which has developed model legislation for states to adopt. I am told, however, that some of the adopting states have chosen not to enact uniform definitions for taxable goods—a simple and basic piece of the package—much less simplify the myriad tax rates among taxing jurisdictions without their state.

If the states cannot even agree to adopt uniform definitions for taxable goods, what assurance does Congress have that the states and localities can act on their own to truly simplify their sales tax structures?

Answer. Mr. Chairman, the Streamlined Sales Tax Project has been working hard to radically streamline and simplify the nation's myriad state and local sales and use tax systems. That effort is ongoing and significant progress has been achieved. The project includes two parts: model state legislation and an interstate agreement. No state will be able to join as a fully participating state unless and until these simplifications, including uniform definitions for taxable goods, have been adopted. We can give no assurance to Congress that all states will adopt the simplifications recommended by the Streamlined Sales Tax Project. However, if Congress would grant the states the authority to mandate collection by remote vendors and specify that this authority was contingent upon adoption of all simplification measures, only those states that have complied would benefit from the authority. This may be exactly the incentive the states and localities need to act positively on the Project recommendations.

Just as Congress has found that simplification of the federal income tax system and campaign finance laws are inherently exceptionally complex and difficult to reform without strong leadership, so too here the complexity is not just daunting, but

involves multiple jurisdictions. The Governors undertook this effort to achieve meaningful change. Any action that Congress can take to provide incentives to assist in our efforts would be invaluable.

Question 2. Your testimony states that the Internet Tax Freedom Act is "being interpreted to allow any transaction to be conducted electronically and thus avoid the collection of state or local sales and use taxes."

Even without the Internet Tax Freedom Act in place, according to the Supreme Court *Quill* decision, aren't states and localities prevented from requiring remote sellers to collect sales taxes because the requirement would be an undue burden on interstate commerce?

Answer. Mr. Chairman, the *Quill* decision bars states from requiring remote sellers to collect and remit sales and use taxes. Some remote sellers do voluntarily, and we applaud them. Other vendors which do have nexus are, understandably, concerned about federally conferred advantages or economic benefits which discriminate against them relative to their non-nexus competitors. This has increased pressure to avoid tax collection responsibilities by means of exploring loopholes in the Internet Tax Freedom Act (ITFA) and to explore the use of subsidiaries or affiliates to operate kiosks or electronic cash registers in order to claim that the in-store purchase was made via a company which has no nexus.

Moreover, with the accelerating changes in technology, the ability to distinguish between the kinds of services entering a home or business through a wire or wirelessly is constantly eroding. As Senator Steven's staff expert indicated when the Act was first considered, 'If I represented the electric, telecommunications, or cable industry; I would be working very hard to define my business as Internet access because of the enormous federal incentives.'

Question 3. Have the Governors who are concerned about lost tax revenues associated with Internet sales explored alternative ways to collect the corresponding use taxes from people who make purchases over the Internet?

Answer. Mr. Chairman, every state conducts audits, just as the Federal Government does, in an effort to ensure compliance. While this is more effective with large businesses with regard to business-to-business Internet sales, it is far more difficult with regard to business-to-consumer sales. States have stepped up notice efforts to advise consumers of their responsibilities and to attempt to undo misleading information that such transactions are tax-free. But, as you can imagine, there are serious privacy issues and enormous enforcement costs to effective collections on individuals. I would venture that if Congress were to eliminate the collection and remittance requirement of the federal airline ticket taxes on the purchase of domestic and international airline tickets purchased over the Internet, Congress and the U.S. Department of Transportation would experience singular difficulties in enforcing the responsibility of individual travelers to voluntarily remit. At the least, it would create an exceptionally cumbersome and intrusive federal bureaucracy just to collect the taxes that were owed.

Question 4. Your testimony states that "the Federal Government is empowered to regulate interstate commerce, but it would be unwise to usurp the most basic rights reserved to the states as to how they may or may not raise or lower revenues."

Given the states' current tax structures, how is Congress proposing to usurp states' rights to raise or lower the tax rates?

Answer. Mr. Chairman, there is no more basic right or responsibility of any level of government than to determine what revenues to reduce or raise in order to meet the needs and priorities of its citizens. As our global economy has become more and more borderless, and as our national economy has shifted more and more to services and technology—and away from manufacturing—the base for the most important source of revenue for states—and for public education in America—has eroded. Some experts project the erosion to be as much as 60 percent.

Much of that is the nature of the economy. But two federal issues arise—action and inaction. The Quill decision invited Congress to step up to the plate and help ensure an equitable system for commerce. Unless and until Congress acts, there will be a continuing and accelerating erosion of state and local sales and use tax revenues. There is no shortage of evidence—from the General Accounting Office, Forrester Research, etc.—of the erosion. Because of the interstate nature of the emerging economy, federal inaction exacerbates this erosion and consequent erosion of state and local rights to determine their taxpayers' and citizens' wishes in this fundamental arena.

Second, the enactment of the ITFA specifically preempted state and local—but not federal—taxation of Internet access and multiple and discriminatory taxes. That is a direct preemption or usurpation of states' rights. In addition, the definitions of

"Internet access" and "multiple and discriminatory" taxes creates avenues to evade or avoid existing state and local taxes. The federal insistence in applying these restrictions on state and local governments, but not on the Federal Government, can only appear to be intended as a direct intrusion into the rights of Wyoming taxpayers to be able to make their own decisions and choices about who and what ought to be subject to the taxes necessary to balance our budget.

Finally, there is legislation pending before the Senate to preempt existing grandfathered states—in violation of Congress' own Unfunded Mandates Reform Act—and to alter existing federal laws in a way that would usurp existing state business activity revenues. These are pending, proposed intrusions that would take away or usurp basic decisions of Governors, state legislators, and municipal elected leaders with regard to our own responsibilities to guard our respective governments' fiscs and to respect the right and will of our own citizens.

We fully respect the right and authority of Congress to eliminate or restrict federal taxes on the Internet. Congress could eliminate federal excise taxes on Internet transactions, federal income taxes on Internet transactions and businesses, etc. We would note that in considering some $1.6 trillion in federal tax relief, however, there has—as yet—been no proposal to provide special tax relief or benefits unique to the Internet or Internet transactions. The only proposals pending in the House and Senate to provide special tax treatment and benefits to the Internet would instead apply only to state and local governments.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO HON. JANE SWIFT

Question 1. What is your response to what appears to be a legitimate concern, that traditional business transactions that are taxable today can avoid sales taxes altogether simply by sellers' setting up an electronic means to complete a transaction?

Answer. This "Kiosk Theory" is simply not true. Some people have mistakenly argued that retail sellers will circumvent current sales tax collection obligations by diverting sales to Internet ready kiosks located inside (or outside) their stores. For example, Consumer X will enter brick and mortar Store Y, and test items before using an in-store kiosk to purchase those very items through Store Y's website, to be delivered either to the store or to the consumer's home, tax-free. The theory is that by using an Internet server located in another state, or by shipping the goods from out of state, a "tax-free Internet" provides an uneven playing field for merchants to exploit the tax code and provide goods more cheaply than competitors, because no tax is assessed and collected.

However, this "tax-free kiosk" assumption is wrong. Under Quill Corp. v. North Dakota. 112 S. Ct 1904 (1992), stores which have a substantial physical presence in a state, and thus "nexus" in that state, must subject their sales transactions to a sales tax (and collect that tax on behalf of the state). Orders taken at in-store kiosks will not allow any store to escape being the location of the sale, because the kiosks themselves will provide physical presence, or nexus. Regardless of the location of the Internet server and location from which the goods are shipped, if the transaction occurs at an Internet terminal located within a retail store, a sales tax must be imposed and collected. Simply put, merchants who have such a physical presence in a state cannot avoid an obligation to collect taxes simply by setting up an electronic means to do business.

If this inquiry involves a traditional retailer establishing a separate corporate entity "to complete a transaction," then the ability of the retailer "to avoid sales taxes" by redirecting sales does not really exist. In order to avoid sales tax obligations in a state, the corporate entity must not have nexus with the state. Generally, a retailer directing a customer to a website, of a separate corporate entity, to complete a particular transaction would vitiate the separation and establish nexus. Furthermore, even if such affirmative redirection could occur, the average shipping charge exceeds the average sales tax. Thus, particularly when coupled with the consumer having to delay receipt, the consumer benefit to such a tax avoidance scenario is vastly overstated.

Question 2. Please be more specific in your critique of the interstate sales tax proposal of the National Governors Association and the proposal itself.

Answer. The National Governors Association has a general policy in support of Congress granting states remote sales tax collection authority. The NGA also has been involved in supporting the Streamlined Sales Tax Project, and has endorsed Senator Dorgan's legislation. Because the NGA itself has not put forward a highly specific proposal, specific critiques are difficult. Philosophically, however, the NGA

approaches this issue with a tax collectors' mentality, and we place a higher priority on maintaining the integrity of the commerce clause, limiting the states' tax powers, and not imposing undue burdens on interstate entrepreneurs. While the NGA believes the states should receive new national tax powers, we believe other values are more important than helping every states' tax bureaucracy achieve revenue collection perfection.

We object to any needless federal, state, or local bureaucracy. We particularly object to an unaccountable bureaucracy. We believe that a compact of the states with an exceptionally broad mandate to collect sales tax on all sales of tangible real property would be accountable to the electorate in no one state and thus be prone to overstep its powers. In any case, we believe it is unlikely Congress would give its sanction to such a compact without including a federal oversight role that we believe would unnecessarily complicate federal/state relations. Regardless of how such a compact is structured, we believe the ultimate impact will be to weaken the sovereignty of individual states not strengthen it.

There is also the issue of enforcement and compliance. Although currently as written, a vote of member states is required to admit a new state to the compact, we do not see adequate safeguards to ensure that (1) a state admitted to the compact is in full compliance with the simplification requirements and (2) it stays in compliance with the simplification requirements. We are very concerned that tax paying Massachusetts businesses that disagree with any ruling by the compact have no means of recourse.

Finally, and perhaps most importantly, the Streamlined Sales Tax Proposal does not close the door on future taxes. Massachusetts companies who could register as tax collectors under the plan have no assurance that, upon assuming the obligation to collect sales tax, they will not themselves be subject to new forms of taxes. States and localities might seek to impose business license or business income taxes on non-present sellers (or at least force such businesses to defend multiple tax audits seeking to impose such taxes). For example, Alabama just enacted a law (SB 806) that would require the state finance department to provide the address of all businesses collecting sales tax to the local jurisdiction for which the tax was collected. Such reports are then used to identify out-of-jurisdiction businesses in order to impose other taxes on them. Thus, the simplification project is just a mechanism for state and local governments to force all businesses to register in every state so that they can impose a multitude of business taxes on them. Small businesses, in particular, will be overly burdened under such a system and often times be forced to pay illegitimate tax assessments, if not put out of business because they do not possess the wherewithal to fight. It is no surprise that large "box" retailers like Wal-Mart are spending millions to lobby Congress to support the NGA's tax power quest. While there are many other concerns, such as privacy, lack of documentation, and a host of technical administrative issues that remain to be resolved, we believe that an open door to nexus creep is the worst aspect of the NGA's remote tax position.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO ELIZABETH HARCHENKO

Question 1. What do you think of the proposal for one tax rate and one tax base per state, for all types of commerce?

Answer. We believe that it is not necessary to impose a strict one-rate or one-base limit on states in order to eliminate unreasonable administrative burdens on interstate commerce arising from sales and use taxes. Current complexity arises from the administrative functions-including reporting functions, rate changes, and liability-with which sellers must comply, rather than from the number of tax rates or differences in tax bases. The Streamlined Sales Tax Project (SSTP) has developed a reasonable and responsible approach to resolving the issue of sales and use tax complexity through statewide administration by participating states and simplification of state and local tax rates and base in a manner consistent with state and local fiscalstability.

The SSTP recommendations would substantially eliminate unreasonable burdens on interstate commerce through statewide administration by participating states. Under the SSTP, the number of returns per tax period can be reduced from hundreds nationwide to just one per state-a dramatic, cost-saving simplification as compared to the current system.

With regard to tax rates, the SSTP recommendations will actually achieve more simplification than would a one-rate-per-state system. States would provide companies with free software that will calculate the tax automatically for each transaction, risk free to the seller. This approach builds on recent advances in informa-

tion technology that make it possible for sellers to know and automatically calculate the actual rate applicable to each transaction. Sellers would be relieved of liability for errors incurring in tax rate information provided by states. Further, states would be required to limit changes in tax rates to occur only quarterly, with a uniform 60-day advance notice of changes in tax rates so that sellers can incorporate the rate changes into their sales software. An automated, simplified and risk-free "one rate per transaction" system will achieve an extraordinary level of simplification without disrupting systems of state and local finance.

The SSTP effort to simplify administrative and tax rate functions goes hand-in-hand with the rationale for allowing states and localities to retain their tax rate structures to enable them to tailor their fiscal policies to fit local needs. Congressional attempts to require states to adopt a one-rate-per-state methodology would dramatically upset the revenue balance within individual states and greatly skew the distribution of revenue within states toward urban areas. For instance, rural areas, with lower populations, demand a lesser share of state and locally funded services-such as education and mass transit-than densely populated urban areas. As such, tax rates in rural areas are generally lower. In contrast, more densely populated areas demand a larger share of these types of services and, thus, routinely assume a higher level of taxation to support those services. If states are forced to accept a one-rate-per-state methodology, then taxpayers in rural areas may be forced to assume a higher level of taxation to fund services in other parts of the states from which they receive no benefit.

With regard to tax bases, the SSTP recommendations would eliminate administrative burdens for interstate sellers through uniform definitions of major items in the tax base and a process of phasing out major variations within each participating state between state and local bases. Variations in tax bases within a state would occur only for large items subject to registration or property taxes-vehicles, boats, manufactured homes and similar items. Consistent with principles of federalism, each state would retain the full sovereign right to determine the taxability of items within their tax base. Thus, tax bases would continue to differ between states. These base simplifications are a common sense approach to easing administrative burdens for all sellers, especially those engaged in interstate commerce.

Question 2. What is your view on the proposal for a bright-line nexus standard that requires physical presence in a state before a company can be subjected to a state's business activity tax?

Answer. Two thoughts come to mind when this suggestion is made-"tax havens" and "litigation." A number of groups are actively seeking to muddy the debate on sales and use tax simplification by inserting the unrelated issue of requiring states to adopt a new and restrictive nexus standards for business activity taxes. The MTC firmly believes these actions and proposals are detrimental to reaching consensus on sales and use taxes, would create "tax havens" that would serve to shift income away from jurisdictions in which it is earned, and would dramatically increase litigation in the corporate tax arena.

The U.S. Supreme Court has established the nexus standard for business activity taxes in a series of corporate income tax cases. For corporate income tax purposes, "nexus is established if the corporation avails itself of the 'substantial privilege of carrying on business' within the state.' Exxon Corp. v. Wisconsin Dept. of Revenue; International Shoe Co. v. Schactel; Ford Motor Company v. Beauchamp; Colonial Pipeline Co. v. Traigle; Memphis Natural Gas Co. v. Beeler; International Harvester Co. v. Wisconsin Dept. of Taxation; and New York ex rel. Whitney v. Graves. These cases clearly establish that physical presence is not required for the imposition of a business activity tax. In this regard, it is important to understand the Quill case applies only to the imposition of a sales and use tax collection obligation and not to business activity taxes.

There is good reason for the current business activity standard. Unlike sales tax collection obligations under which the states ask sellers to serve as collection agents, business activity taxes are the quid pro quo imposed on those who take advantage of the benefits of doing business within the states. Does the company take advantage of the consumer market by selling goods or services; does the company take advantage of the infrastructure—transportation systems, telecommunications networks, labor force, raw materials; does the company enjoy the protection of the court system to enforce its contracts and collect debts? These are the questions the court asks when determining whether a business organization is "doing business" sufficiently to justify the states asking for a contribution toward the cost of maintaining the infrastructure that affords that organization the opportunity to earn income from its activities within the state. The states must afford interstate business the same benefits that it affords their own resident businesses. The states cannot keep

interstate business out; the states must scale the measure of their business activity taxes to the level of the business activity that occurs. And the states should be able to ask fair return for maintaining their markets and infrastructure for the benefit of interstate business enterprises.

The proposals advocated by some groups would dramatically change current law by replacing the constitutional "substantial privilege of doing business" standard with physical activity standards. We addressed the problems that would arise from imposing these new and excessive restrictions on state business activity tax authority in our letter of March 6, 2001 to Senators McCain and Hollings.

The proposals advocated by some with regard to business activity taxes would dramatically change existing law. Typically the proposals would impose new restrictions on state authority in the form of physical activity standards of nexus for business activity taxes (including corporate income taxes, gross income or gross receipts taxes, and capital stock and franchise taxes). The imposition of these new standards would simply create and multiply within the business activity tax realm many of the problems that have existed in the context of sales and use taxes. Again, tax equity would suffer. Companies earning income from within a state and benefiting from state and local services would be excused from paying their fair share of the cost of those services. These proposals would elevate corporate form over economic substance and allow companies, through sophisticated tax strategies, to shift income unfairly away from where it was earned to tax haven locations. In terms of tax equity, the net result of the proposals would be to allow a select group of corporations to escape their fair share of state and local taxes and to shift that burden to wage-earners, small businesses and traditional manufacturing and natural resource industries-all of which are "captive" within the taxing state.

These proposals for new restrictions on state authority to levy business activity taxes would also detract from economic efficiency and balanced economic development by, again, discouraging the flow of investment across state boundaries. The physical activity approach to state authority is really an anachronism arising out of 17th and 18th century mercantilism. Centuries ago, the only way enterprises could earn income from a territory would be to undertake physical activities there. Today, companies can earn substantial income from a state-and in the process benefit from the services of a state-with only minimal activities that might traditionally be labeled "physical." To achieve tax neutrality-taxing the same income earned in the same state to the same degree-concepts of physical activity as a standard for state taxing authority need to be assigned to the dustbin of history. If companies can earn income from within a state, but escape taxation by keeping their activities within the boundaries of certain physical activities defined in a new federal law, then companies will be discouraged from going beyond those physical activities and making new and more substantial investments in that state. Thus, the proposals for new federal laws restricting state business activity taxes will only interfere with the free flow of commerce and balanced economic growth across the nation.

Further, a federal statute that revises the current standard for business activity tax nexus could increase the amount of litigation in this area of tax law several fold. Today, sophisticated tax strategies are being developed that would appear to anticipate these proposed changes in federal law. These strategies would allow companies to shift income away from where it is earned into tax havens-both domestic and international. If a federal statute is enacted and these strategies are implemented, states and localities will be forced to audit and legally challenge the validity of such arrangements (in order to protect the integrity of their tax systems vis a vis their own local industry)-forcing companies to reveal the origin of their income and instigating what surely would constitute decades of legal entanglement. Effectively, these complex tax strategies and the resulting litigation would adversely affect the revenue streams of many state and local governments-forcing many jurisdictions to pursue cutbacks in services or a shift of the tax burden to wage-earners, small business and traditional manufacturing and natural resource industries.

Finally, we doubt that it is possible to define by law a true "bright line" test. The proposed "tests" we have seen are unclear and subject to widely varying interpretations. Several of the "tests" seem to invite creation of separate corporate entities, not because there is a business purpose but solely in order to avoid paying state taxes. These conditions invite the kind of uncertainty and litigation that the proponents decry.

Thus, the MTC urges Congress to reject proposals that pursue creation of a new and restrictive nexus standard that requires physical presence for the application

of state business activity taxes. Such a standard would ultimately result in more litigation, greater costs of administration and an unfair system of state taxation.

○