

**Final Draft Submitted to the Commission  
from the Report Drafting Subcommittee  
12-3-99**



**Issues and Policy Options Paper**

**Introduction**

Congress created the Advisory Commission on Electronic Commerce (the "Commission") to study a wide variety of issues involving taxation of electronic commerce including both domestic and international. The Commission's statutory mandate calls for "a thorough study of federal, state and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities." Congress provided the Commission 18 months to undertake this broad examination, after which the statute requires the Commission to "transmit to Congress for its consideration a report reflecting the results, including such legislative recommendations as are required to address the findings of the Commission's study...."

Pursuant to the Commission's Work Plan, this Policy Issues and Options paper attempts to record and synthesize the major policy issues and alternative resolutions of those issues that the Commission process has raised thus far. The appearance of any of the proposals, issues, options, or areas of potential agreement in this paper should not be interpreted as approval by the Commission. Rather, the descriptions constitute the first step toward reaching a set of consensus recommendations to be transmitted to Congress in a final report. The Commission reviewed the proposals submitted in response to the Commission's listed criteria, and distilled from those proposals and the public hearings issues and options. This document represents those areas that the Commission believes merit further discussion.

Through the Commission hearings and testimony, receipt of public comments including proposals, and dialogue among Commissioners, some common themes have surfaced. These themes are likely to guide the Commission's debate and discussion as it works to resolve the important policy issues identified throughout this paper. Following is a proposed list of themes that are candidates for consensus.

1. It is in the national interest to establish an environment that continues to foster innovation and technological advancement in the development of the Internet and electronic commerce. The aggressive and innovative manner in which United States' businesses have embraced the Internet is a major national asset. Such national interest merits federal, state and local policymakers' review of laws and regulations affecting the growth of electronic commerce.

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- 39 2. Any federal policies in this area should be respectful of the sovereignty of state and local  
40 jurisdictions and be respectful of interstate commerce. The best way to strike the balance  
41 between national and state interests will be through earnest and open debate of issues and  
42 options by representatives of federal, sub-federal and private sector participants.  
43
- 44 3. With or without a federal mandate, state and local governments should make every effort to  
45 simplify current sales and use tax systems. The complexity of current sales and use tax  
46 systems fosters non-compliance, often imposes uncompensated burdens on businesses and  
47 others in the tax system, and has the potential to stifle increased investment in the Internet.  
48 Multiple audits should be avoided and overlapping tax and regulatory regimes should be  
49 harmonized to facilitate cooperation and trust among public officials, businesses and  
50 taxpayers as well as reduce administrative burdens.  
51
- 52 4. The interests of all parties – federal, state and local governments, businesses of all sorts and  
53 consumers – are best served by a tax system that is efficient and fair. The advent of electronic  
54 commerce raises new issues for traditional state and local tax systems, and such systems  
55 must be adapted to the changing environment if they are to continue to remain viable in the  
56 21st century.  
57
- 58 5. The interests of all parties – federal, state and local governments, businesses of all sorts and  
59 consumers – are best served by a strong and vibrant Internet economy. The advent of  
60 electronic commerce raises new issues for the way government operates and taxes people,  
61 and both must be adopted to the changing environment if they are to remain viable in the 21<sup>st</sup>  
62 century.  
63
- 64 6. At this time, it does not appear that there is any compelling reason to impose taxes  
65 exclusively targeted at electronic commerce.  
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- 68 7. State, local and federal governments often grant tax preferences to certain forms of business,  
69 marketing and commerce for a variety of public purposes. Internet commerce produces  
70 significant benefits affecting the general public. A central policy question for governments at  
71 all levels is whether those benefits produced by Internet commerce justify similar preferential  
72 tax treatment, or whether there should be tax treatment that neither advantages nor  
73 disadvantages electronic commerce.  
74
- 75 8. Governments should keep tax burdens on American consumers and businesses as low as  
76 possible, and should recognize the role of state and local governments to continue providing  
77 needed services to their citizenry.  
78
- 79 9. The Internet is not only an important and useful tool for electronic commerce; it is becoming  
80 a medium for the transmission of medical development and practice, educational materials  
81 and other essential information. Policymakers at all levels of government should strive to  
82 ensure that the benefits of the Internet are available to all citizens, regardless of geographical  
83 location or economic circumstances. In order to ensure access to all individuals and

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84 businesses, the cost of access and transmission should be kept as low as possible and not be  
85 subject to excessive taxes or government regulation.

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87 10. As electronic commerce continues to grow and government policies are formulated,  
88 policymakers at all levels of government should be particularly mindful to respect consumer  
89 privacy rights.

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91 11. In order to foster the growth of electronic commerce, any recommendations for change  
92 should remove financial and logistical burdens on sellers.

93

94 12. Any federal, state or local tax policy should not undermine United States global  
95 competitiveness in Internet commerce generally or any particular business sector specifically.

96

97 13. Any national policies adopted regarding international taxes and tariffs on Internet commerce  
98 should bolster United States global competitiveness.

99

100 These guiding themes are the basis for the discussion of the specific issues that the Commission  
101 has identified to try and resolve in the coming months.

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103 For purposes of this document, the term, "Transaction Taxes" includes any sales tax, use tax  
104 excise tax, or other tax or fee imposed on a per-transaction basis.

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**I. International Tax & Tariff Issues<sup>i</sup>**

**Defining the Issue**

What recommendations should the Commission make to Congress regarding international tax and tariff policies?

**Policy Options**

1. Work toward harmonization of certain basic principles.
  - Inconsistent basic tax policies may impede or limit the international growth potential of electronic commerce.
  - Nondiscriminatory and neutral taxation of electronic commerce are two fundamental principles that should be adopted worldwide in order to ensure that electronic commerce serves as a viable trade vehicle between different countries.
  - Jurisdictional and administrative rules should be harmonized so that tax administrators can coordinate collection and remittance of Transactional Taxes due with respect to cross-border transactions. Harmonization should ensure that no taxable transaction is subject to double taxation or no taxation.
2. There should be no international taxes on electronic commerce.
  - The United States should oppose the imposition of any international taxes on Internet-based sales and transactions originating in the United States.
  - The Administration should vigorously oppose discriminatory taxes by foreign countries on U.S. sales conducted electronically, including bit and byte taxes.
3. Recommend a Tariff-Free Internet.
  - Tariffs on international commerce are by definition discriminatory imposts.
  - The administration of tariffs on electronic commerce, particularly the transfer of digital products and services, would be extremely difficult if not impossible.
  - The United States has been a leader in international trade discussions in winning acceptance of the Internet and electronic commerce as a "tariff-free zone."
  - Due to the potentially discriminatory effects of such tariffs and the compliance issues associated with them, the Commission should encourage the federal government to continue its pursuit of a ban on tariffs on electronic transmission in international trade negotiations.
4. Recommend continued federal leadership.

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- The federal government by law and institutional role has, and must continue to play, the leadership role in negotiating for U.S. interests in international trade and tax organizations and fora.
- It is especially important that the U.S. government consult state and local governments and others in discussions involving the taxation of electronic commerce since, currently, the most pressing international discussions involve consumption taxes, and the primary U.S. consumption tax is the state and local sales tax.
- The Commission should encourage the U.S. government to establish an active, ongoing vehicle for communication with the various interests regarding the international tax and trade issues affecting electronic commerce and involving such interests actively in these discussions. This would enable the federal government to be apprised of the positions and concerns of the state and local governments and others as they participate in international discussions as well as provide a vehicle for the U.S. government to insure that domestic interests are able to keep abreast of actions being taken internationally.

*Area of Potential Agreement*

In order for electronic commerce to serve as a viable trade vehicle between different countries, the international harmonization or adoption of certain basic principles should be encouraged. For example, non-discriminatory and neutral taxation of electronic commerce should be an internationally adopted principle.

*Area of Potential Agreement*

Tariffs are inherently discriminatory and are aimed at protecting one country's goods and services to the detriment of another country. The United States should refrain from imposing tariffs on electronic transmissions and should encourage other countries to follow suit.

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**II. Tax Treatment of Internet Access<sup>ii</sup>**

**Defining the Issue**

Should Congress leave as is, increase, or decrease the authority of state and local governments to impose Transaction Taxes on the sale of Internet access?

**Policy Options**

1. Extend the moratorium on taxing Internet access set forth in the Internet Tax Freedom Act for five additional years, while modifying the Act to prohibit states already taxing Internet access from collecting such taxes.
  - Nothing has changed since the original moratorium was passed.
  - Congress needs more time to solve the potential double tax problem posed by taxing Internet access.
  - Extending the moratorium will enable e-commerce, which is a relatively new and emerging industry, a chance to develop without the market distortions caused by a haphazard tax structure.
  - Extending the moratorium will prevent it from lapsing prior to the conclusion of national dialogue about if or how e-commerce should be taxed.
  - Currently, states are flush with revenue and thus there is no need for an alternative source of revenue.
2. Prohibit state and local governments from imposing any Transaction Taxes on the sale of Internet access. (Repeal any existing Transaction Taxes and impose no new taxes on access.)
  - Keeping the cost of access to the Internet as affordable as possible will promote interstate commerce and universal access to this medium.
  - Taxing Internet access represents a discriminatory, "multiple" taxation because it is, in essence, already taxed once when Internet service providers pay sales tax to telecommunications providers for backbone transmission service
  - Taxing Internet access may contribute further to the "digital divide," because it increases the price of access, making access less affordable particularly for lower income people, which, in turn, would result in their being technologically disadvantaged.
  - Taxing access in addition to taxing items sold over the Internet may slow the growth of the Internet.
3. Permit state and local governments the option of imposing Transaction Taxes on Internet access.
  - The goal of preserving state and local government sovereignty prevails over the need for congressional intervention.

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- There is no fundamental reason to provide favored treatment to this kind of transaction over similar types of transactions. Other services that are important to the growth of our economy are taxed and, similarly, Internet access should not be favored.
- Given the lack of a compelling administrative or policy rationale for an exemption, states should be free to impose the general sales and use tax on such transactions if they so choose. Some states have chosen to impose their sales and use taxes on a broad range of service transactions or on a broad range of information services.
- Excluding Internet access from sales/use tax would complicate compliance and administration, because Internet access is commonly bundled with other (presumably taxable) products.

*Area of Potential Agreement*  
Internet access should not be subject to any Transaction Taxes.

**III. Tax Treatment of Telecommunications Service Providers<sup>iii</sup>**

**A. Transaction Taxes**

**Defining the Issue**

Telecommunications service providers are currently subject to a complex federal, state and local tax system that evolved prior to the development of electronic commerce. The current system, in some cases, imposes burdensome taxes on telecommunications services when compared to other businesses. Likewise, it often discriminates among providers within the general category of telecommunications because not all providers of similar services are subject to the same tax regime. Should the current telecommunications tax system be simplified as part of a comprehensive plan that addresses the taxation of access to electronic commerce?

**Policy Options**

1. Dramatically simplify the current telecommunications Transaction Tax system (including filing and auditing procedures) with the result being that state and local governments would be required to standardize procedures, definitions, limit the number of Transaction Taxes, and repeal the 3% federal excise tax imposed on communications services.
  - Advances in technology ensure that there will be a variety of vehicles available for accessing the Internet (e.g., telephone lines, satellite, and cable). The Commission (or Congress) should consider all possible backbone transmission vehicles together and should ensure that consumers are not discriminatorily taxed on the method of transmission through which they choose to receive Internet access.
  - Administratively burdensome taxes on telecommunications service providers increases the cost of transmission services to consumers, potentially increasing the digital divide and reducing the number of consumers who can participate in the growth of electronic commerce.
  - Sound tax policy does not justify singling out any industry to bear a disproportionately large burden for raising revenues for states and localities.
  - The reasons for implementing this complex excise tax structure, and the underlying economic structure on which it was premised (i.e., a rate-regulated monopoly) no longer exist.
2. Reduce taxes on the current telecommunications structure, with the first step being to eliminate the 3% federal excise tax on communications services.
  - Comprehensive telecommunications tax reform should be considered as part of a much more in-depth study (which would include a review of fees imposed on the industry - an area outside the scope of this commission.) Notwithstanding, the 3% federal communications excise tax should be eliminated now, because it is an easily identified burden on the telecommunications industry and consumers.

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- American consumers would benefit because the cost of telecommunications services could be reduced in a competitive market to reflect savings in company overheads. Reduction in telephone costs reduces the cost for some to log-on to the Internet.
  - The purpose for which this tax was initially imposed no longer exists. Congress first enacted a 3% federal excise tax on each consumer's local and long-distance telephone service as part of the Spanish War Act of 1898 to fund America's effort in the Spanish-American War.
3. Create incentives for state and local governments to simplify telecommunications taxes by distributing revenues from the 3% federal telecommunications excise tax to state and local governments in exchange for a reduction in the level and complexity of state and local telecommunication taxes.
- State and local governments would be in a much better position to simplify and reduce their telecommunications taxes if the revenue losses were minimized by distribution of the 3% federal excise tax.
  - One option would allow the tax to be phased-out gradually. The federal government would immediately eliminate 2% of the 3% federal excise tax and would continue the tax at 1% for three additional years. At the conclusion of three years, the federal excise tax would be completely abolished.
  - In return for simplifying their existing taxes, state and local governments would be ceded a new revenue stream from the federal government amounting to \$1.7 billion (based on 1999 figures) this year and doubling to \$3.4 billion ten years from now. Those funds would compensate states and localities for any sales taxes foregone to Internet-based commerce.
  - States that do not simplify state and local telecommunications taxes would not be ceded the 1% federal tax and would lose the chance after three years when the federal tax would automatically be abolished at the federal level.
4. Encourage state and local governments to work cooperatively with the telecommunications industry to reduce complexity and cost of complying with telecommunications taxes; adopt tax policies that consistently treat like-services (i.e. telephone, information, data and content) without regard to the manner in which the services are delivered (i.e. telephone lines, cable, or wireless); and, adopt a uniform means of treating "bundled" telephone, cable, Internet and other services (i.e. those that include items that are taxable and those that are not taxable in a single price.)
- Tax reform of converging technologies is something that should be first attempted by the affected industries and state and local governments. The recent Mobile Telecommunications Sourcing proposal is an example of how industry and state and local governments can work together to develop a solution to a complex and complicated tax problem.

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5. Recommend no change in the way local, state and federal taxes are applied to telecommunications, cable and the Internet backbone.

- The various patterns of telecommunications taxes across states and the manner in which they are integrated into the state and local revenue system probably make it extremely difficult for a single, mandated approach to reform.
- A "one-size fits all" approach to state and local telecommunications tax reform would lead to serious revenue dislocations in some states.
- Other industries also bear high tax burdens; there is precedent for placing high tax burdens on some industries compared to others.
- The federal excise tax produces substantial revenue and eliminating it must be considered in light of other tax and governmental priorities.

*Area of Potential Agreement*  
Eliminate the 3% federal excise tax on communications and support an in-depth examination of comprehensive telecommunications tax and fee reform, with an eye towards simplification. Any reform in this area must be examined in light of revenue and budgetary implications.

**B. Property Taxes**

**Defining the Issue**

Should Congress prohibit state governments from imposing higher property tax burdens on interstate telecommunications property than on other general business property?

**Policy Options**

1. Recommend prohibiting state governments from singling out interstate telecommunications property for higher ad valorem taxation by enacting federal legislation extending 4-R property tax treatment to telecommunications carriers (and other industries involved in Internet backbone transmission infrastructures) engaged in interstate commerce.
  - Interstate telecommunications companies should be afforded the same tax treatment as their competitors for property tax purposes. Tax discrimination will be eliminated and investments and expansion of the Internet encouraged.
  - Any excessive taxes on the backbone infrastructure may restrict access to the Internet either through higher costs to users or under-investment in capital expansion in backbone infrastructure.
2. Preserve states authority to determine the nature and level of ad valorem tax on interstate telecommunications property.

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- The interests of state and local governments in preserving their sovereignty outweigh the need for federal intervention.
- In some jurisdictions, this could impose a tax shift on non-telecommunications properties. In other situations, some state and local governments could experience revenue losses.
- Other industries also bear disproportionately high tax burdens; there is a precedent for placing higher tax burdens on some industries compared to others.

*Area of Potential Agreement*

**IV. The Application of Transaction Taxes to Sales Conducted  
Through the Internet<sup>iv</sup>**

**A. Tax Treatment of Tangible Personal Property and Taxable Services**

**Defining the Issue**

Should Congress leave as is, increase, or reduce the authority of state and local governments to impose Transaction Taxes on sales of tangible personal property and taxable services sold through the Internet? If Congress does intervene, to what extent should it mandate simplification of the existing sales and use tax administration system?

**Policy Options**

1. Extend the moratorium of the Internet Tax Freedom Act for five additional years, while modifying the prohibition against sales and use taxes to prohibit all sales taxes on Internet business to consumer sales of tangible or intangible goods and property, intellectual property, digital goods, services, securities, information and entertainment.
  - Nothing has changed since the original moratorium was passed.
  - Extending the moratorium will enable e-commerce that is a relatively new and emerging industry a chance to develop without the market distortions caused by a haphazard tax structure.
  - Extending the moratorium will prevent it from lapsing prior to the conclusion of national dialogue on how e-commerce should be taxed.
  - Currently, states are flush with revenue and thus there is no need for an alternative source of revenue.
  
2. Recommend making no change in state and local governments' authority to impose Transaction Taxes on sales of tangible personal property facilitated by the Internet. Taxes would be imposed by state and local governments in the same manner and to the same extent as they impose Transaction Taxes on sales facilitated through any other means (including face-to-face retail sales and mail order sales).
  - The Internet is simply another vehicle for transacting business and no overriding policy reason justifies allowing transactions conducted via the Internet to enjoy tax-favored treatment.
  - The Internet Tax Freedom Act requires this Commission to issue recommendations that are tax and technologically neutral. Recommending a tax-free Internet is arguably not neutral.
  - With future advances in technology, more businesses may transact business electronically while conducting business in the traditional "brick and mortar" manner. Requiring businesses to treat electronic commerce and remote sales differently than other sales will increase administrative burdens for sellers.

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- A "no change" recommendation allows state and local governments the autonomy to impose sales/use tax in a manner consistent with current nexus standards and allows all forms of commerce to proceed as they currently do.
  - Because Congress has no responsibility for the delivery or non-delivery of state and local services, Congress should choose to refrain from making decisions that impact tax revenues used for such services.
3. Recommend pre-empting state and local governments' authority to tax sales of tangible personal property or services via the Internet, making such sales exempt from any Transaction Taxes.
- The growth of electronic commerce and the value of the Internet as a whole would be substantially diminished if transactions were burdened by Transaction Taxes.
  - The current complex sales and use tax system places an substantial burden on interstate commerce, which should, at least until fundamental simplification measures are actually implemented, override the state and local government interests in exercising their sovereign powers to impose taxes on Internet sales.
  - In certain circumstances, vendors may not be able to comply with the existing tax system, such as when the situs of a transaction is unknown.
  - As a vehicle with which to conduct commerce of all forms, the Internet presents tremendous potential for future economic growth that should not be impeded by the imposition of state and local governments' complex sales/use tax systems.
  - Pre-emption of state and local governments' authority to impose sales/use tax may provide an element of consumer tax relief.
  - Pre-emption of state and local governments' authority to impose sales/use tax on all electronic commerce may foster innovation, technological growth, and economic prosperity.
4. Recommend prohibiting all sales and use taxes on business-to-consumer Internet transactions by amending the Internet Tax Freedom Act to prohibit all sales taxes on Internet business to consumer sales of tangible or intangible goods and property, intellectual property, digital goods, services, securities, information, and entertainment.
- The temporary moratorium contained in the Internet Tax Freedom Act should be extended to a permanent prohibition against the imposition of tax burdens on business-to-consumer electronic commerce.
5. Encourage the development and implementation of a voluntary system for collecting sales/use taxes on electronic commerce and remote sales that would eventually utilize advanced technologies to overcome certain complexities and would eliminate the financial and logistical tax collection burdens and liability of the seller.

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- A recommendation incorporating fundamental simplification of sales/use tax systems with a shifting of tax collection burdens from the seller to an approved third party agent of the state recognizes both the seller’s need for user-friendly tax systems and government’s need for revenue to fund basic services; it establishes a new business paradigm for business and government alike.
  - A program whereby a third party, approved by and acting on behalf of the states, bears the burdens of tax collection, reporting and liability holds a number of potential advantages, including virtually eliminating all burdens currently imposed on sellers. While such a recommendation requires states to bear the economic burdens of implementation and approved third party charges, it preserves the sales/use tax system in an electronic environment, and allows for the real time remittance of taxes.
  - Using advanced technologies to overcome some of the current complexities serves to protect state and local governments’ discretion and sovereignty, and it does not favor one form of commerce over another.
  - This recommendation could be expanded to include traditional “brick and mortar” commerce.
  - The national interest in an efficient marketplace and a vibrant state and local sector may argue that the federal government should provide financial assistance to the development and implementation of such a voluntary system.
  - This option requires no change to current nexus standards.
6. Recommend requiring state and local governments to simplify sales/use tax systems in a manner meeting certain federally mandated requirements negotiated by interested public- and private-sector parties in consultation with federal policymakers.
- A recommendation for simplification conforming to federally mandated requirements provides nationwide consistency and certainty for sellers.
  - Federally mandated requirements strike a balance between jurisdictional sovereignty and the national interest of sustaining and promoting the information highway to electronic communication.
7. Recommend imposing a nationally collected, single rate, uniform sales/use tax on electronic commerce and remote sales in lieu of all sales/use taxes; all revenues to be shared with state and local governments.
- If required to collect sales/use tax in all jurisdictions, electronic commerce and remote sellers would face multiple rates, laws/rules that are inconsistent from state to state, and multiple administrative agencies.
  - A recommendation to impose a nationally collected sales tax provides simplicity, a single nationwide rate, uniform definition and registration, and a single party responsible for collection/administration/distribution of revenue.
  - Although this recommendation does not preserve the sovereignty of state and local governments, it does assure that tax is being paid/collected on all taxable

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508 sales. It would also provide a vehicle for offsetting any revenue dislocations  
509 currently being occasioned.

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**B. Taxation of Digitized Goods**

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**Defining the Issue**

514 Should Congress leave as is, reduce, or eliminate state and local governments' authority to  
515 impose sales/use tax on electronic commerce transactions involving transfers of digitized goods  
516 (e.g., videos, music, and software?)  
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**Policy Options**

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520  
521 1. Recommend states and local governments retain the authority to tax or exempt digitized  
522 goods in a manner consistent with tangible goods and taxable services.

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- 524 • The conversion of tangible personal property into digitized goods does not change  
525 the essence of what is being sold and therefore does not provide an overriding  
526 policy reason for allowing them tax-favored treatment.

527

528 2. Recommend pre-empting state and local governments' authority to impose sales/use tax on  
529 those electronic commerce transactions involving transfers of digitized goods.

530

- 531 • The invasiveness of the necessary enforcement system outweighs the revenue  
532 effects of foregoing taxation. Because of the interests in neutrality, such a  
533 recommendation should be accompanied by a concomitant exemption for sales of  
534 comparable tangible goods.

535

- 536 • The difficulty (or even impossibility) of determining the identity and the location  
537 of the consumer of digitized goods makes the imposition of sales and use taxes to  
538 these transactions virtually impossible without requiring the consumer to provide  
539 the requisite information to analyze the taxation of such a transaction.

539

540 3. Impose a central or federal sales tax on sales of digitized goods and, by formula, distribute  
541 the revenue to the states.

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- 543 • A central or federal tax treats digitized goods in a manner consistent with their  
544 tangible counterparts, yet resolves the issue of determining where the sale occurs.

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*Area of Potential Agreement*

There should be no taxes on digitized goods.

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**C. Nexus Concerns**

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552 **Defining the Issue**

553 If Congress intervenes with regard to state and local governments' authority to impose  
554 Transaction Taxes on sales of tangible personal property and taxable services conducted or  
555 performed through the Internet, should the existing nexus standards be applied to such  
556 transactions for purposes of determining a seller's obligation to collect and remit such taxes?  
557

558 **Policy Options**

559  
560 1. Recommend preserving the status quo: out-of-state merchants making sales of tangible  
561 personal property facilitated by the Internet should not be required to collect Transaction  
562 Taxes if they do not meet the "substantial nexus" standard articulated in *Quill v. North*  
563 *Dakota*.<sup>1</sup>  
564

- 565 • The national interest in not burdening interstate commerce and permitting the  
566 natural growth of electronic commerce overrides the state and local government  
567 interests in preserving or increasing their sales and use tax revenue base.
- 568 • Out-of-state sellers should not be required to collect transaction taxes for states in  
569 which they do not utilize the governmental services funded by such taxes, and in  
570 which they have no political representation.
- 571 • The growth of electronic commerce may be impeded and the value of the Internet  
572 as a whole may be substantially diminished if the current system of sales and use  
573 taxes were imposed on electronic commerce.
- 574 • The Supreme Court's interpretation of nexus standards has not changed. The  
575 current state and local sales/use tax system is non-uniform and uncoordinated  
576 among the more than 7,600 different tax jurisdictions. Exporting tax collection  
577 responsibilities beyond state borders would be unfairly burdensome on interstate  
578 merchants who have no "substantial nexus" in a taxing state and would be  
579 incompatible with electronic commerce.
- 580 • The states desire to preserve its tax system, designed prior to the Internet era,  
581 provides no rationale for Congress to extend to them National taxing powers.  
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583 2. Recommend redefining existing nexus standards to provide state and local government with  
584 expanded authority to impose tax collection duties on out-of-state sellers, even though the  
585 sellers have no physical presence in the taxing state.  
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- 587 • Establishing a nationwide collection obligation would provide a simple, certain  
588 solution to current nexus disputes, would foster a level playing field among  
589 competing retailers selling into the same marketplace and would protect state and  
590 local governments' sales tax revenue base from eroding.
- 591 • The lower cost to consumers of tax-free sales over the Internet may make it the  
592 preferred means of purchase, and possibly hurt sales of retailers who choose not  
593 to sell over the Internet.  
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<sup>1</sup> *Quill v. North Dakota*, 504 U.S. 298 (1998)

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- 595 3. Recommend clarifying existing nexus standards by identifying, with greater precision than  
596 under current law, the business activities in which taxpayers involved in interstate commerce  
597 may engage without being subject to state and local tax collection obligations.  
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- 599 • The implementation of fundamental simplification of the sales and use tax system  
600 combined with nexus clarification would result in increased voluntary compliance  
601 with tax collections and reduced administrative burdens for sellers.
  - 602 • Such a standard would create uniform rules defining what activities allow a state  
603 or its political subdivision to tax or impose collection responsibilities on out-of-  
604 state businesses.
  - 605 • It should also provide a list of specified activities that an out-of-state business can  
606 conduct within a state that will not subject it to taxation by the state in which the  
607 activities are conducted.
  - 608 • It should apply to all state taxes and not be limited to sales taxes or Internet  
609 transactions.
  - 610 • One option would be to specify the activities that should not create tax nexus.  
611 These would include, but are not limited to: solicitation of orders or contracts,  
612 shipment of goods, presence of intangible properties, the use of the Internet, ISPs,  
613 or servers, the affiliation with another entity, the use of an unaffiliated  
614 representative or independent contractor.

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**V. Impact on Business Activity Taxes<sup>v</sup>**

**Defining the Issue**

Should bright-line standards be adopted to identify certain situations in which a taxpayer would be deemed not to have sufficient nexus for Business Activity Taxes (e.g., income, gross receipts, franchise taxes)?

**Policy Options**

1. Recommend adopting bright-line standards for Business Activity Taxes nexus including extending the protections of P.L. 86-272 to all state and local government taxation.
  - The business community's concerns over being subjected to unfair income or business activity taxes has been heightened by recent court rulings in several states that impute "substantial nexus" in various legal contexts due to their virtual or electronic presence.
  - States traditionally have imposed their corporate income and related business activity taxes only upon businesses that physically exist in their jurisdictions. The Internet, however, makes companies ubiquitous, and more state tax collectors have begun to impute "substantial nexus" to companies due to their virtual or electronic presence, or due to their ownership of equipment needed solely to transfer information in a cyber economy.
  - Such standards would help minimize the likelihood that state and local governments would inadvertently discriminate against electronic commerce businesses.
  - The existing federal statute that provides such a bright-line test was written more than 40 years ago and needs to be updated to account for modern changes in the economy, particularly the advent of the Internet and electronic commerce.
  - Such standards would provide express protection to companies that sell intangibles, services and information in addition to the current protection for only the sale of tangible goods.
  - A company that owns only intangible property in a state would not have "substantial nexus" in a state and would not be subject to income or business activity taxes in that state.
  - For the past 30 years, states have shown a complete inability to deal with this problem, which is why federal preemption is required.
  
2. Recommend no change in current business activity taxes.
  - Existing standards based on interpretations of the U.S. Constitution's commerce and due process clauses have worked reasonably well.

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- Different standards that effectively exempt aspects of the new economy from the payment of business taxes may increase pressure on the taxation of in-state taxpayers. Multistate business may be favored over single-state businesses.
  - This could reduce revenues that are currently being collected. States that rely on business activity taxes and not on sales and use taxes could be affected disproportionately.
  - Any change in the current standards could encroach upon the state and local governments' powers to interpret the nexus standards within their jurisdiction. States could address any problems themselves rather than requiring federal intervention.

671 3. Recommend requiring electronic commerce businesses to pay Business Activity Taxes on a

672 basis reasonably equal to all other businesses earning income in a state by encouraging states

673 to develop uniform apportionment methods for all enterprises, including those conducting

674 electronic commerce, and by adopting nexus standards for all businesses based on clear and

675 certain levels of economic activity.

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- Neutral tax policies that treat all types of businesses in a comparable manner are the tax policy most likely to maximize economic growth over the long term.
  - Business activity taxes are a "true" benefits received tax and should be proportionate to economic activity.
  - Nexus standards based on clearly specified levels of economic activity are true "bright line" standards that cannot be manipulated by either taxpayers or tax authorities and ensure equitable treatment of all businesses competing in a state's marketplace.
  - P.L. 86-272 (15 USC § 381 et. Seq.) is more than 40-years old and was intended to be temporary in nature and therefore its continued viability should be examined.

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**VI. Redress Mechanism for Imposition of Unconstitutional State and Local Taxes<sup>vi</sup>**

**Defining the Issue**

Should Congress establish a mechanism to ensure that taxpayers can obtain effective and timely redress for the states' imposition of unconstitutional taxes?

**Policy Options**

1. Congress should act to ensure that in the e-commerce environment taxpayers are entitled to receive refunds, and reasonable attorney fees, in cases where state taxes, or tax exemptions, may be unconstitutional.
  - States sometimes impose unconstitutional transaction and business activity taxes that discriminate against out-of-state firms. States sometimes continue to impose these taxes, or fail to provide meaningful redress, even when such taxes have been ruled illegal by the Supreme Court.
  - The existing redress procedures are burdensome, complex and unfair, and obtaining refunds is virtually impossible.
  - The Tax Injunction Act made sense in a cash register economy, but should be updated, because the existing system of taxpayer redress is particularly problematic in the e-commerce environment. The Internet provides even the smallest firms with national market access, but currently only large businesses have the wherewithal to challenge unconstitutional tax assessments. Small firms have no practical recourse but payment for unconstitutional tax assessments that discriminate against out-of-state businesses.
  - Congress should act to ensure that meaningful redress exists when unconstitutional taxes are imposed. Otherwise, states have no incentive to alter their behavior, and the problem will only grow larger as e-commerce continues to grow.
  
2. Congress and the Supreme Court have spoken in this area; the standards and requirements are clear. No further intervention is necessary.
  - The U.S. Supreme Court has clearly spoken on the issue of refunds and remedies. In *McKesson Corp. v. Division of Alcoholic Beverage Control* [496 U.S. 18 (1990)], the Court held that if states do not provide a "predeprivation remedy" (i.e., an opportunity to enjoin collection of tax or withhold payment), then they must provide "meaningful backward looking relief." Such relief may be in the form of refunds or other acceptable means of undoing the damage caused by the unconstitutional statute. To suggest that states may simply "refuse to pay refunds" is extremely misleading in light of the jurisprudence in the area.
  - The proposal raises serious Tenth and Eleventh Amendment issues.

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- The proposal upsets the delicate balance that the states and the federal government have reached in the important area of state taxation. Developing special remedy rules for a special set of taxpayers has the potential to create inconsistent understandings of state law.
- Just because the party that did not prevail takes issue with the court's decision does not mean that the decision is wrong or that Congressional intervention is necessary.
- A "one-size-fits-all" remedy is not appropriate for this highly complex area of law where many competing interests are involved.
- This issue is beyond the scope of the Commission's charge.

***Area of potential Agreement***

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**VII. Digital Divide<sup>vii</sup>**

**Defining the Issue**

What steps should Congress take to reduce, with the goal of eliminating, the Digital Divide and empowering needy families in rural America and inner cities to participate in the Internet economy?

**Policy Options**

1. Amend federal welfare guidelines to permit states to spend Temporary Assistance to Needy Families (TANF) Surpluses to Buy Computers and Internet Access for Needy Families.
  - Due to the success of welfare-to-work reforms and the booming economy, welfare rolls have been reduced dramatically across the United States. Consequently, many states have accumulated surpluses of federal TANF funds.
  - Under federal statutes and regulations, states arguably could use TANF funds to empower needy parents and their children with computers and Internet access.
  - TANF surplus funds are a rational and available source of funds to accomplish this objective without increasing taxes and without creating all-new entitlement programs.
  - Poor families should have the same tax-free opportunity to purchase clothing and food, to invest in securities, and to obtain critical information about employment and educational opportunities as anyone else.

***Area of potential Agreement***

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**ENDNOTES**

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\* *Proposals cited are not endorsements by the Commission. These materials provide resources from which the Commission has distilled some of the issues and options contained in this document.*

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## **I. International Tax & Tariff Issues**

- <sup>i</sup> Alistair Kelman, “The easyClear White Paper” (Proposal # 98)

## **II. Tax Treatment of Internet Access**

- <sup>ii</sup> Governor Jim Gilmore, chairman and commissioner, “No Internet Tax” (Proposal #107)
- e-Freedom Coalition, “The e-Freedom Coalition’s Proposal” (Proposal # 138)
- U.S. Representative, John Kasich, Small Business Survival Committee, “Internet Tax Elimination Act” (Proposal # 144)
- James M. Goldberg, North American Retail Dealers Association, “A Proposal from the North American Retail Dealers Association,” (Proposal #145)

## **III. Tax Treatment of Telecommunications Service Providers**

- <sup>iii</sup> Jeffrey A. Eisenach, “The High Cost of Taxing Telecom” (Proposal #51)
- Commissioner Dean Andal, “A Prohibition of Discriminatory Ad Valorem Taxation of Interstate Telecommunications” (Proposal #104)
- Governor Jim Gilmore, chairman and commissioner, “No Internet Tax” (Proposal #107)
- Air Touch, ALLTEK, Bell Atlantic, BellSouth, CommNet Cellular, Global Crossing, GTE, SBC, Sprint, US West, Western Wireless, “Proposal for State and Local Taxation of the Telecommunications Industry” (Proposal #124)
- e-Freedom Coalition, “e-Freedom Coalition’s Proposal to the Advisory Commission on Electronic Commerce” (Proposal #138)
- Commissioner Dean Andal, “A Uniform Jurisdictional Standard: Applying the Substantial Physical Presence Standard to Electronic Commerce” (Proposal 146)

## **IV. The Application of Transaction Taxes to Sales Conducted Through the Internet**

- <sup>iv</sup> Robert D. Atkinson, Progressive Policy Institute, “Internet Taxation” (Proposal #66)
- Wayne Eggert, “Electronic Commerce; Modernization and Sales Tax Simplification Proposal” (Proposal #102)
- Paul Francisco, TaxNet systems, Inc., “Sales and Use Tax Collection on Interstate Purchases” (Proposal #106)
- Governor Jim Gilmore, chairman and commissioner, “No Internet Tax” (Proposal #107)

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- Andrew Wagner, “Proposal of an Origin Based Tax Solution for the Possible Taxation of Digitized Products Sold Over the Internet” (Proposal #108)
- Austin W. Dunn, “Multijurisdictional Electronic Commerce Taxation Proposal” (Proposal #109)
- Joseph F. Taricani, Interstate Solutions, LLC “The Simplification of Collections and Remittance on Remote Consumer Sales” (Proposal #110)
- David Polatseck, Data Processing Center, “Sales Tax Simplification Proposal (Proposal #112)
- Charles E. McClure, “Radical Simplification of State Sales and Use Taxes: The Prerequisite for and Expanded Duty to Collect Use Tax on Remote Sales” (Proposal #113)
- William Olders, Data Kinetics, Ltd. ,“A Foundation for Automating the Taxation of E-Commerce” (Proposal #114
- David Hardesty, “Sales Use Tax: Creation of the Multistate State Tax Service” (Proposal# 115)
- ATRACS Corp. “ATRACS Corporation” (Proposal #116)
- Ronald E. Knox, Esalestax.com, “Proposal to Address Issues of State and Local Taxation of Internet Transactions for the Advisory Commission on Electronic Commerce” (Proposal #117)
- John M. Peha, “Proposal on Taxation of Electronic Commerce” (Proposal #119)
- Daniel L. Sullivan, Taxware International, Inc. “Adapting Tax Technology to the Internet – the eCommerce Transaction Tax Server” (Proposal # 120)
- Kaye Caldwell, CommerceNet, “A State Cooperative Approach to Collection of Use Taxes in Interstate Commerce” (Proposal #122)
- Hal R. Varian, “A Proposal to Eliminate Sales and Use Taxes” (Proposal # 125)
- Senator Ernest F. Hollings, “Sales Tax Safety Net and Teacher Funding Act, S. 1533” (Proposal # 126)
- Danielle Bujnak, Independence Forum, “Proposal for Advisory Commission on Electronic Commerce” (Proposal # 127)
- William F. Willbrand, MPP&W Consultants, “Sales/Use Tax Settlement System” (Proposal # 128)
- Thomas A. McGuire, “The Zip Code Tax” (Proposal #132)
- Clifford A. Farmer & Gregory M. McCauley, The Sales Tax Clearinghouse, “Proposal from the Sales Tax Clearinghouse” (Proposal # 133)
- Governor, Michael O. Leavitt, commissioner, National Governors Association, National Conference of State Legislatures, Council of State Governments, National Association of Counties, The United States Conference for Mayors, International City/County Management Association, “Streamlined Sales Tax System for the 21<sup>st</sup> Century” (Proposal #134)
- David A. Lifson, American Institute of Certified Public Accountants, “The Proposal from the American Institute of Certified Public Accountants, “American Institute of Certified Public Accountants” (Proposal #135)

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- Diann L. Smith, Committee on State Taxation, “Proposal from the Committee on State Taxation” (Proposal #136)
- Richard N. Kappler, Global Crossing, Ltd., “A Proposal for Fostering the Fast and Efficient Development and Operation of Internet Web Hosting Facilities” (Proposal #137)
- The e-Freedom Coalition, “The e-Freedom’s Coalition’s Proposal” (Proposal # 138)
- eCommerce Coalition, “Simplification of the state and Local Sales and Use Tax System” (Proposal #139)
- William McArthur & Peter Merrill, “A Modest Principle: No Net NetTax” (Proposal # 141)
- Representative John Kasich, Small Business Survival Committee, “Internet Tax Elimination Act” (Proposal # 144)
- James M. Goldberg, North American Retail Dealers Association, “A Proposal from the North American Retail Dealers Association,” (Proposal #145)
- Commissioner Dean Andal, “A Uniform Jurisdictional Standard,” (Proposal #146)

<sup>v</sup> Quill v. North Dakota, 504 U.S. 298 (1998)

## **V. Impact on Business Activity Taxes**

- <sup>vi</sup> Commissioner Dean Andal, “A Uniform Jurisdiction Standard” (Proposal #146)
- Hal R. Varian, “A Proposal to Eliminate Sales and Use Taxes” (Proposal # 125)
- Air Touch, ALLTEK, Bell Atlantic, BellSouth, CommNet Cellular, Global Crossing, GTE, SBC, Sprint, US West, Western Wireless, “Proposal for State and Local Taxation of the Telecommunications Industry” (Proposal #124)
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## **VI. Redress Mechanism for Imposition of Unconstituional State and Local Taxes <sup>vi</sup>**

## **VII. Digital Divide**

- <sup>vii</sup> Governor Jim Gilmore, chairman and commissioner, “No Internet Tax” (Proposal #107)