

Internet tax freedom costs states

State and local governments could be shortchanged on revenues to fund public services should Congress adopt proposals for freeing e-commerce from taxes.

BY ELAINE STUART

The future of state and local governments' ability to fund vital public services hangs in the balance as Congress considers exempting electronic purchases from sales taxes.

At press time, the U.S. House May 10 approved H.R. 3709 to extend the current moratorium on new Internet taxes for five years. Moreover, the House bill would eliminate the ability for 10 states, which were exempted under the current moratorium, to collect Internet access taxes. The House acted quickly after receiving the congressional Advisory Commission on Electronic Commerce's report April 3.

The ACEC, created by Congress in 1998, split 11-8 on many issues. Business members and Virginia Gov. James Gilmore aligned with the majority side.

The majority view in the report asks Congress to pre-empt the current tax law of many states. This pre-emption would jeopardize funds for essential public services and give significant tax system benefits to e-commerce retailers at the expense of Main Street retailers. In an April press conference, state leaders of The Council of State

Governments urged Congress not to embrace the majority report. CSG opposes action by Congress this year, especially extension of the moratorium on Internet taxes.

State leaders speak out

"The plan allows larger, and often wealthy, Internet companies to avoid being taxed themselves and to avoid charging taxes to customers," said Illinois state Rep. Tom Ryder, CSG chairman. "Yet, loyal, local Main Street retailers pay these taxes and may be crippled in their competitiveness if the plan is adopted."

In addition, the report's proposals could turn the digital divide into a canyon as wealthier people buy online tax-exempt, while low-income people buy at local stores where they pay sales taxes.

"Government policy that further widens the digital divide between haves and have nots must be rejected," said Kentucky Gov. Paul Patton, CSG president.

The majority view in the report called for:



PHOTOS BY MICHAEL LAWSON, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION

- Eliminating existing sales taxes on items such as books, compact discs and newspapers whether sold in local stores in nondigitized form or over the Internet in digitized form. This would pre-empt current tax law in many states and jeopardize state funding for public services such as education, public safety, health and welfare.

A divided commission

Gilmore, ACEC chairman, said the report, nearly a year in the making, “will guide public-policy debate on Internet taxation for at least the next decade.” Many of the proposals, however, fell two votes short of the two-thirds majority mandated by Congress. The majority votes were included in the report, but not as formal recommendations.

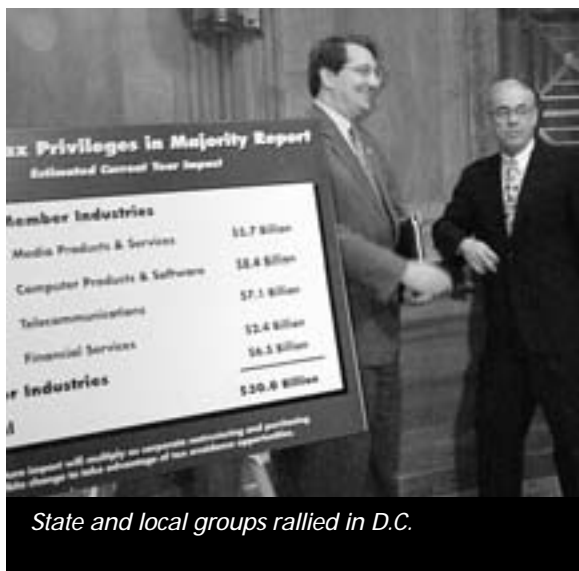
The majority report called for eliminating the 3 percent federal excise tax on telecommunications services, which would represent an immediate tax cut of \$5 billion. Removing the tax, Gilmore said, would lower the price of Internet access and help close the digital divide.

The majority view also called for extending the current moratorium on “multiple and discriminatory” taxation of electronic commerce for an additional five years through 2006. It also would make permanent the moratorium on Internet access taxes, which expires in 2001.

The report said state and local governments should draft a uniform sales-and-

Tax barriers?

While some contend that the existence of more than 7,000 taxing authorities nationwide imposes too great a burden on Internet retailers, others maintain software solutions could overcome potential collection problems. According to press reports, about two dozen states are working with various companies such as IBM Corp., Taxware International, Inc., and Esalestax.com to devise technology to identify taxes due for online sales, collect the tax and distribute it to the states where it is owed. What is needed is software that tracks different rates of sales taxes and adjusts for local rules. In this case, a technology fix might ease acceptance of a political solution.



State and local groups rallied in D.C.

- Allowing e-commerce companies to avoid paying income, property and other taxes by affiliating with companies in states without those taxes.

- Giving special tax treatment to “dot.com” businesses while requiring Main Street retailers to collect taxes, thus putting them at a competitive disadvantage.

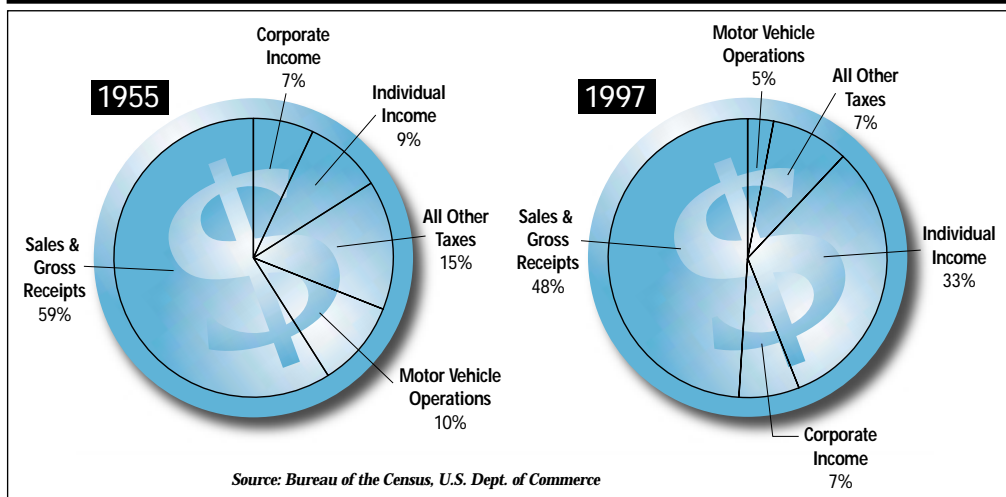
“We cannot accept this proposal as it places the profits of some over the good of the whole people,” Patton said. “Seriously jeopardizing the stability of state revenue structures, furthering the divide between haves and have nots, and crippling Main Street retailers is poor public policy that should be rejected.”

use tax act by Oct. 21, 2004, to simplify sales and use taxes.

To help close the digital divide, the commission recommended that Congress clarify state authority to spend TANF funds to provide needy families access to computers and the Internet. It also recommended providing tax incentives and federal matching funds to states to encourage public-private partnerships to increase access.

Gilmore, addressing the 2000 Glo-

State Sales & Gross Receipts: 1955-1997



bal Internet Summit held at George Mason University, Fairfax, Va., on March 13, said, "As chairman of the congressional Advisory Commission on Electronic Commerce, I have proposed that sales taxes on electronic

low success rate in collecting the taxes on consumer purchases made over the Internet. Sales and use tax revenues account for nearly one-fourth of all state and local government revenues.

As more consumers buy online, the

pay use taxes on catalogue and Internet purchases.

A plan for uniformity

Commission member Utah Gov. Mike Leavitt, testifying before the U.S. Senate Commerce Committee, urged Congress to let states set their own tax policies.

Leavitt said eight commissioners supported a plan to let states and localities undertake a plan to simplify state sales-and-use taxes in exchange for the clear right to collect the taxes.

They recommended that Congress enact legislation to allow states to develop an Interstate Sales and Use Tax Compact by Dec. 31, 2003 to ensure a level playing field and reduce the tax and administrative burden on business and consumers.

Other officials support simplifying taxes. "State leaders in every branch of government remain committed to streamlining and simplifying the states' tax-code systems, while retaining essential, critical public services, and treating retailers — and the people — fairly," said Ryder of Illinois.

Most officials want a level playing field. Michigan Gov. John Engler urged Congress not to ban sales-and-use taxes on Internet commerce. Engler said a ban "would be an unprecedented intrusion on the rights of states to set their own tax policy."

In February testimony to the Senate Budget Committee, Engler said exempting Internet sales "is, in essence



U.S. Sen. George Voinovich, R-Ohio, joins state and local leaders in calling for fairness in Internet taxation.

commerce not be imposed on remote transactions between businesses and consumers. States should abolish use taxes, which are difficult to enforce. The 3 percent federal telecommunications excise tax should be abolished, and no government should be able to tax access to the Internet."

Massachusetts Gov. Paul Cellucci and Colorado Gov. Bill Owens are among the governors who have supported Gilmore's anti-tax stance. Cellucci, who calls his state the "dot commonwealth," said a sales tax on top of a handling and shipping charge would hurt e-commerce.

In contrast, 42 governors sent letters to Congress opposing the tax moratorium after the ACEC report came out.

Gilmore's no-tax plan was welcomed by U.S. House Speaker Dennis Hastert, R-Ill.

Tax-free cyberspace?

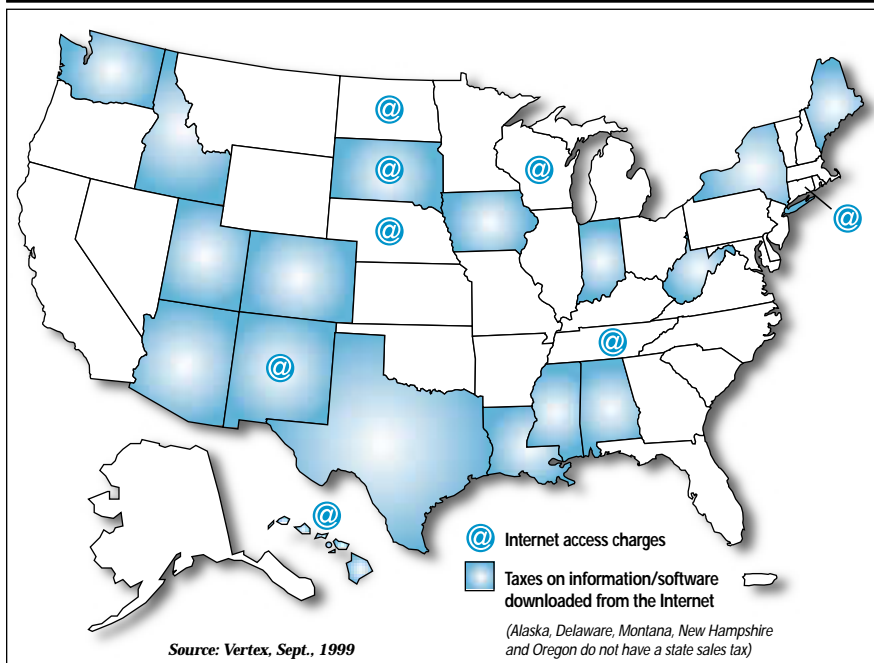
Under current practice, the 45 states that impose sales and use taxes have a

fear is that these revenues will fall in states such as Kentucky and Tennessee, where revenues are tight. Under a 1992 U.S. Supreme Court case, state and local governments cannot require remote sellers, whether Internet firms or mail-order sales, to collect and remit sales taxes unless the firm has a substantial physical presence in the state. If a remote seller does not collect the sales tax, then the consumer is supposed to voluntarily pay the use tax. Few consumers, however, report and

Commission members

Virginia Gov. James Gilmore, chairman; Michael Armstrong of AT&T; Grover Norquist of Americans for Tax Reform; Richard Parsons of Time Warner Inc.; Bob Pittman of America Online; David Pottruck of Charles Schwab Corp.; John Sidgmore of MCI WorldCom and UUNET; Stan Sokul of the Association for Interactive Media; Ted Waitt of Gateway Inc.; Dean Andal of the California Board of Equalization; Virginia Delegate Paul Harris, Commissioner Delna Jones of Washington County, Ore.; Dallas Mayor Ron Kirk; Utah Gov. Mike Leavitt; Washington Gov. Gary Locke; Gene Lebrun of the Commissioners on Uniform State Laws; Joe Guttentag of the Department of Treasury; Andy Pincus of the Department of Commerce, and Bob Novick of the Office of U.S. Trade Representative.

States with charges on Internet access & downloading software



Federal proposals

The 1998 Internet Tax Freedom Act expires October 2001. The current act stops new taxes on Internet access and does not cover sales-and-use taxes. Bills before Congress include:

- S. 1611 and H.R. 3252, introduced by Sen. John McCain, R-Ariz., and Rep. John Kasich, R-Ohio, to expand and make permanent the current tax moratorium;
- S. 2028 and H.R. 3709, introduced by Sen. Ron Wyden, D-Ore., and Rep. Christopher Cox, R-Calif., to make the tax moratorium permanent. The House passed an amended H.R. 3709 on May 10 extending the moratorium by five years.
- S. 2255, introduced by Sen. John McCain, R-Arizona, to extend the tax moratorium by five years.

a double standard: good for clicks, bad for bricks.”

United in opposition

In a March 30 statement, Leavitt of Utah, Washington Gov. Gary Locke, Dallas Mayor Ron Kirk and Delna Jones, a county commissioner from Oregon, said the report would immediately reduce state and local tax revenues by more than \$20 billion a year and would “force either reductions in education, transportation and public-safety programs, or offsetting revenue increases on every other taxpayer.”

By giving certain companies tax exemptions not enjoyed by others, the proposal “could force thousands of small retailers in every small town across America into bankruptcy,” the state and local commissioners said. The ACEC did not include even one retailer or small-business representative.

Public-interest group leaders joined CSG leaders at the April press conference. They included representatives of the National Governors’ Association, the

National League of Cities, U.S. Conference of Mayors, National Association of Counties, National Conference of State Legislatures and International City/County Management Association. Moreover, executives of major retail stores, including Target Stores, Radio Shack, J.C. Penney, Circuit City and Sam’s Clubs, said they oppose creating a tax-free marketplace for some Internet sellers.

U.S. Sens. George Voinovich, R-Ohio; Bob Graham, D-Fla., and Byron Dorgan, D-N.D., joined the state and local leaders. Voinovich, a former governor and mayor, said, “State and lo-

cal governments aren’t interested in taxing but in coming up with a system that is fair.”

Ryder of Illinois cited Voinovich’s appearance at the D.C. press conference while presenting Voinovich with CSG’s Guardian of Federalism Award at the organization’s spring meeting April 29 in Napa, Calif. Ryder said, “Sen. Voinovich led the charge against congressional actions that would limit state and local sovereignty and clearly described how Internet taxation would impact state and local governments and the citizens they represent.”

CSG resources

CSG’s Washington, D.C., office has information on the commission’s report and a link to the commission’s Web site (www.ecommercecoalition.org) on the CSG Web site, www.csg.org. For more information, contact Kristin Cormier in the D.C. office, (202) 624-5460. The CSG Intergovernmental Committee discussed the issue at the Spring Task Force and Committee Meeting in Napa Valley, Calif., April 29.

Electronic Commerce: Revenue Implications for States, C200-9900, is available for \$20 from CSG’s Sales Department, e-mail, sales@csg.org, or call (800) 800-1910.