

INTERNET TAX MORATORIUM AND EQUITY ACT

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BEFORE THE
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COMMERCIAL AND ADMINISTRATIVE LAW
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CONTENTS

JULY 18, 2001

OPENING STATEMENT

The Honorable Bob Barr, a Representative in Congress From the State of Georgia, and Chairman, Subcommittee on Commercial and Administrative Law	1
The Honorable Melvin L. Watt, a Representative in Congress From the State of North Carolina, and Ranking Member, Subcommittee on Commercial and Administrative Law	2

WITNESSES

The Honorable Ernest J. Istook, Jr., a Representative in Congress From the State of Oklahoma	
Oral Testimony	9
Prepared Statement	11
Mr. Grover G. Norquist, President, Americans for Tax Reform, and Member, Advisory Commission on Electronic Commerce	
Oral Testimony	14
Prepared Statement	16
Mr. Frank G. Julian, Operating Vice President and Tax Counsel, Federated Department Stores, on behalf of The Direct Marketing Association and The Internet Tax Fairness Coalition	
Oral Testimony	18
Prepared Statement	20
Mr. Jon W. Abolins, Vice President for Tax and Government Affairs, Taxware International, Incorporated	
Oral Testimony	31
Prepared Statement	33

APPENDIX

Material Submitted For The Record	55
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INTERNET TAX MORATORIUM AND EQUITY ACT

WEDNESDAY, JULY 18, 2001

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:06 p.m., in Room 2141, Rayburn House Office Building, Hon. Bob Barr [Chairman of the Subcommittee] presiding.

Mr. BARR. I would like to call this hearing of the Subcommittee on Commercial and Administrative Law to order.

I welcome all the guests who are with us today and welcome the Subcommittee Members and staff and certainly our distinguished panel of witnesses today.

I think we will also be joined at some point during these proceedings by a couple of other Members of the full Judiciary Committee who, although they are not Members of this Subcommittee—shame on them for that—but even though they are not Members of this Subcommittee, they do have a keen interest in the legislation that we will be considering today, and that is legislation drafted and introduced by the distinguished gentleman from Oklahoma, Mr. Istook. They have asked to be present, and while they will not ask questions, each of them has asked for a little bit of time to make a statement, and we certainly will accommodate their request to do that.

The Internet and related information technologies are becoming an increasingly vital component of U.S. economic health. Businesses have utilized the commercial potential of the Internet to reach out to customers in a digital, national, and global marketplace. These commercial opportunities have leveled the playing field by allowing small businesses to avail themselves of a national—indeed international—market once reserved to a handful of major corporations.

In 1998, the United States Congress passed the Internet Tax Freedom act, which prohibits multiple and discriminatory taxes on Internet commerce. Contrary to popular misconceptions, some of which have been advanced by pro-taxing organizations, this moratorium emphatically does not exempt Internet retailers from collecting and remitting sales taxes. Rather, it only protects Internet users from taxes on Internet access fees and against predatory State and local taxes levied specifically on goods sold online.

Since passage of the Internet Tax Freedom act, online commerce has seen steady growth rates, but predictions that the Internet would quickly dominate all retail sales have failed to materialize. In fact, Internet retail sales comprised less than 1 percent of total retail sales in fiscal year 2000. Moreover, recent weaknesses in the technology sector highlights the potential vulnerability of this medium.

On October 21, 3 short months away, this limited moratorium on Internet taxation expires. Failure to extend this protection will give States and localities free rein to impose a host of crippling and potentially fatal taxes on Internet commerce.

Last year, the House overwhelmingly passed an extension of the moratorium, but it did not receive a vote in the Senate. This year, there is simply no time for further delay.

On June 18, this Subcommittee held a hearing on H.R. 1552 and H.R. 1675, two bills that would preserve the taxing stability of the Internet by extending the moratorium. At that hearing, I committed to an additional hearing that would address concerns that the current taxing environment unfairly burdens traditional retailers, many of whom have opened online subsidiaries of their own. Today's hearing reflects that commitment.

State governments have been moving toward uniform sales and use tax standards for years, and interstate sales tax simplification proposals have long resisted consensus. It must be stressed that nothing prohibits States from entering into a uniform sales tax compact that could then be submitted to the Congress for its approval. However, the frustrating pace of these efforts has led some to call for congressional intervention toward that end.

The bill we consider today extends the moratorium on discriminatory taxes created by the Internet Tax Freedom act for an additional 5 years. It also protects State power to collect Internet access taxes if these taxes were collected prior to passage of the act. H.R. 1410 also provides simplification criteria that would allow States to impose tax collection burdens on remote sellers without unduly burdening interstate commerce.

The Senate is currently mired in ongoing negotiations concerning the congressional role in this debate. While halting progress has been made in this direction, the time to act is quickly running out. We simply cannot afford to wait.

At this time, I would like to recognize the distinguished Member from North Carolina, the Ranking Member of this Subcommittee, Mr. Watt, for an opening statement.

Mr. WATT. Thank you, Mr. Chairman. I will be brief.

I want to thank Chairman Barr for scheduling the second hearing on this important issue and for inviting a cross-section of people to talk about this issue.

I think if there was one thing that came out of the first hearing, it was an amazing amount of agreement that an extension of the moratorium on Internet access taxes is important and that we need to do that. I do not think there is any controversy about that.

The question is can we at the same time, or in concert with that if not at the same time, get to a point where we can incentivize or reach consensus on simplification of local sales and use taxes so that we can get State and local governments out of the predica-

ment which they perceive that they are in even though, technically, they probably are not in under the legislation that was previously passed.

There is a strong perception out there that this moratorium stops States and local government from imposing sales and use taxes, and that plus the lack of consensus about how we might be able to package and collect those sales and use taxes is creating the situation where brick-and-mortar retailers feel that they are at a distinct disadvantage as opposed to online retailers. We need to try to solve that problem, too. I think that that is what Mr. Istook's bill is designed to move toward. I am happy that he is here to talk about that bill today.

I am also happy that we have a witness here who can begin to at least give us some technical information about the technology and the software that may be available to simplify the collection of local sales and use taxes so that we can see what steps are being made in that direction.

I consider these hearings, both the first one and this one, important in terms of informing us about what the current situation is not only on the moratorium for access taxes but on the current situation with State and local sales and use taxes and also informing us what steps we need to take to try to solve both of these issues. Whether we can solve them both in tandem or whether they have got to be separated, my jury is still out, but I do not want to give up on solving both of them at the same time unless it is absolutely obvious that we cannot solve both of them at the same time.

So I appreciate the Chairman scheduling the second hearing and look forward to hearing all the witnesses, and I especially thank Mr. Istook for being here to talk about his bill.

Thank you very much, Mr. Chairman. I yield back.

Mr. BARR. I thank the gentleman from North Carolina.

I would like to recognize now the distinguished Vice Chairman of the Committee, Mr. Flake, from Arizona.

Mr. FLAKE. I have no opening statement. I just want to thank the Chairman for scheduling the hearing as well and look forward to listening to the witnesses.

Mr. BARR. Thank you.

I would like to recognize the distinguished former Chairman of this Subcommittee, the gentleman from Pennsylvania, Mr. Gekas, for any opening statement.

Mr. GEKAS. I thank the Chair.

The Chair and the Ranking Minority Member have quite succinctly pointed out that there is a sense of urgency here, because October looms in the near horizon, and knowing that the other body puts less emphasis on timetables than this body does, it is appropriate that the Chair has gone forward with this hearing today.

What we must do after this hearing, it seems to me, is follow up on a quick timetable of our own so that we can give lead time to the other body.

I thank the Chair.

Mr. BARR. Thank you.

Mr. BARR. We have a very distinguished panel of experts with us today just as we did a few weeks ago when we considered pieces

of legislation that had been introduced and sponsored by Representative Christopher Cox of California.

The bill that we are taking up today for hearing is introduced and sponsored by Representative Istook of the State of Oklahoma, and he will be our lead-off witness.

Let me, though, if I could, take a few moments to introduce to the audience, both here and for the record, all four members of our panel today.

Representative Ernest Istook is a graduate of Baylor University and obtained his law degree from the University of Oklahoma City. While attending law school, Representative Istook worked as a radio reporter in Oklahoma City. He later served as director of the State Alcoholic Beverage Control Board. Mr. Istook practiced law before being elected to the Oklahoma State House in 1986. He served in that body for 6 years before he was elected to represent Oklahoma's 5th Congressional District in 1992. He currently serves on the Appropriations Committee, where he is chairman of the Treasury, Postal, and General Government Committee.

Mr. Istook is a primary cosponsor of H.R. 1410, the bill we will consider at today's hearing. We appreciate, Representative, your taking the time to be with us today.

Next, we will hear from Mr. Grover Norquist. Mr. Norquist is president of Americans for Tax Reform, a coalition of taxpayer groups opposed to higher Government taxation. He served on the Advisory Commission on Electronic Commerce, which delivered a detailed report to the Congress on the taxing implications of the Internet.

Before joining Americans for Tax Reform, Mr. Norquist served as an economist and speech writer at the U.S. Chamber of Commerce during the Reagan administration and is executive director of the National Taxpayers Union.

Mr. Norquist obtained his M.B.A. and undergraduate degree in economics from Harvard University.

We appreciate your taking time to be with us and share your expertise today, Mr. Norquist.

Next, we will hear from Mr. Frank Julian, who is operating vice president and tax counsel for Federated Department Stores, which operates more than 400 stores in 33 States under the names of Bloomingdale's, Burdine's, Goldsmith's, Lazarus, Macy's, Rich's, Stern's, and The Bon Marche. He appears today on behalf of the Direct Marketing Association and the Internet Tax Fairness Coalition.

Mr. Julian received a bachelor of science degree in accounting from the University of Kentucky and his law degree from Notre Dame. He is a certified CPA and serves as chairman of the Direct Marketing Association's Use Tax Steering Committee.

Mr. Julian also is a member of the Advisory Council of the Sales and Use Tax Alert. He has published many articles dealing with State and local taxing issues and has testified in both the House and the Senate on numerous occasions.

Thank you, Mr. Julian, for being with us today.

Finally, we will be hearing from Jon Abolins. Mr. Abolins is vice president of TAXWARE International's Tax and Government Affairs Department, where he is responsible for all tax decisions in

all company programs. In this key function, Mr. Abolins applies his knowledge of tax law to products that address all transaction-based taxes—in other words, sales and use taxes, gross receipts taxes, excise, VAT taxes, et cetera. He is also responsible for sustaining TAXWARE's relationships with tax authorities and legislative bodies around the globe, frequently advising legislators and regulators seeking to simplify tax laws and rules through technology.

Mr. Abolins is a graduate of the University of Southern California and the Boston University School of Law. He is licensed to practice law in Massachusetts and is a member of the Taxation section of the American Bar Association. Mr. Abolins frequently speaks at sales and use tax or e-commerce tax automation policy meetings to such entities as the Streamlined Sales Tax Project, the National Governors' Association, the U.S. Conference of Mayors, the National Conference of State Legislatures, the Multistate Tax Commission, the Northwest Regional Sales Tax Pilot Project, and the Louisiana Association of Tax Administrators.

As I said to Representative Cox at our last hearing, it is always good to have a fellow Trojan here, and we appreciate your being with us today, Mr. Abolins.

We have been joined by two additional Members of our Subcommittee, and I would like to call on them if they have any opening statements.

Mr. Issa, the distinguished gentleman from California.

Mr. ISSA. Thank you. Since I came late from International Relations, I will make mine very brief.

I repeatedly have been both on the business side and now on the congressional side in these kinds of hearings and meetings, and the consistent pattern of how do we tax, do we tax, don't we tax, what is a lost revenue seems to always center on treating the Internet separately. And I want to once again go on the record saying that you can never treat Internet issues in a vacuum. There are bills circulating around this House today that specifically try to say they are going to do this to the Internet; but in my 20 years in business, I can see their claims of defining nexus in various ways as altering very quickly the relationship between the States and companies outside of those States.

So I would just like to go on record very quickly as saying that I have not yet found an Internet-only law, and I think that is probably the most important thing for everyone to focus on, is the unintended consequences of trying to deal with this as other than interstate commerce that just happens to use a data phone instead of a telephone.

Thank you.

Mr. BARR. I thank the gentleman from California.

We have also been joined by another distinguished Member of the Subcommittee, the gentleman from New York, Mr. Nadler, and he is recognized for any opening statement.

Mr. NADLER. Thank you. I too will be brief, and I thank the Chairman.

Let me first say I agree with the remarks of my distinguished colleague from California, Mr. Issa, about not considering the Internet in a vacuum.

I think it is important to promote Internet commerce, to promote e-commerce, that we continue a prohibition on taxes to access the Internet and on multiple taxation of the Internet.

Having said that, I have to say something else, too. That is, our goal, or one of our goals, ought to be to make the economy of the United States as efficient as possible and to have as rapid economic growth as possible. To do that, you want economic choices to be made on the basis of economics, not on the basis of taxes, and different modes should not have different tax treatments. And people, in deciding whether to buy something at the neighborhood store or at the mall on the one hand, or online at the other hand, should consider whatever they want to consider, but not differential tax consequences. We should not be favoring the Internet by saying there are no sales or use tax on things purchased over the Internet, and we should not be favoring the bricks-and-mortar by giving them preferential tax status.

The economy will be most efficient and most productive when economic decisions are made on a level taxation playing field. Therefore, I think it is imperative, for that reason as well as for the reason of protecting the tax bases of the State and local governments, which some might not think ought to be protected because they have an ideology that no government at any level should do anything, but for those of us who do not share that ideology, we do have an interest in protecting the tax bases of the State and local government as well. So for both of those reasons, it is important that we enable State and local government to levy sales and use taxes if they wish to—it is their choice, or should be their choice—on products purchased over the Internet as well as products purchased at the local store. And figuring out how to do that without subjecting a seller to 6,900 different tax computations is one of the things that the States through the State Governors are trying to do, and I hope that as part of extending the moratorium on access and multiple taxes, we will solve the problem and be able to enable the States and local governments to effectively levy use and sales taxes if they wish to.

I thank the Chairman, and I yield back.

Mr. BARR. I thank the gentleman from New York.

We are also happy to be joined by the gentlelady from Pennsylvania, Ms. Hart, and she is now recognized for any opening statement she might care to make.

Ms. HART. Thank you, Mr. Chairman, and I want to thank our distinguished panelists for taking the time to be with us today.

This is an issue that we wrestled with in the State legislature when I served in Pennsylvania as a State Senator and I chaired the Senate Finance Committee, which had the charge of dealing with taxes. What we decided to do at that time was nothing. We were big fans of the moratorium and basically looked at it sort of if we are going to act at all, the best thing to do would not be to place more taxes on more sales, but to try to find a way to just get rid of the tax to begin with.

Now, wouldn't that be great, and in a perfect world, obviously, we would not all be sitting here. However, we obviously have to consider some of the issues that have been brought before us by the retailers, who have brought before us the issue, of course, of wheth-

er we are being fair or not—and they believe, of course, that we are not being fair if we allow one mode of sales to not be taxed while another is.

So there are lots of issues out there, and it is something that I know this Congress has looked at prior to my joining it, and I am pleased now to be part of this Committee so that I can hopefully be part of the solution. But I am eager to hear from our panelists, and I thank the Chairman.

Mr. BARR. I thank the gentlelady.

As I mentioned a few moments ago, we expected to be joined by some Members of the full Judiciary Committee who, although not Members of the Subcommittee, have a keen interest in matters before this Subcommittee, and we are pleased to welcome two Members of the Judiciary Committee who fall into that category, the gentleman from Virginia, Mr. Goodlatte, and the gentleman from Alabama, Mr. Bachus.

With the unanimous consent of the Committee, I would like to recognize those two gentlemen for 2 minutes each for any statement for the record they might care to make.

The gentleman from Virginia is recognized for 2 minutes.

Mr. GOODLATTE. Thank you, Mr. Chairman. I very much appreciate the opportunity to again join your panel as we address this very important issue.

I am a strong supporter of the legislation introduced by Congressman Cox which would extend the moratorium on new and discriminatory taxes on the Internet. I think we have a long way to go before it is appropriate for the Congress to address—I think the States have a long way to go before it is appropriate for the Congress to address the sales tax issue.

But another issue that has come up that I would like to bring to the Committee's attention is contained in legislation that I introduced yesterday along with Congressman Boucher, with Congressman Cox, as a matter of fact, as a cosponsor of the legislation, that addresses an issue that was raised by the Advisory Commission on Electronic Commerce, the chairman of which is the Governor of Virginia, Jim Gilmore. The majority on that commission recommended that Congress establish national standards for when States can impose business activity taxes.

In point of fact, the Congress did pass legislation in this area over 40 years ago, but that legislation, which is Public Law 86-272, is out-of-date. It was limited to dealing with tangible personal property—the nature of interstate transactions, particularly with the use of intangible personal property on the Internet, the use of trademarks, the use of various computer software and so on have raised a whole net set of issues dealing with when it is appropriate for States to impose various types of corporate and business activity taxes. Some States have attempted to do that just when a retail store in the State puts out an ad that includes the logo of a company that has no other nexus with the State but that their product is sold by that retail store, attempting to impose corporate taxes on that out-of-State corporation just for that very marginal contact. So we think that law needs to be updated. We think that the legislation dealing with the tax moratorium is the perfect vehicle for doing that, because these issues are so closely related.

As a result, it is my hope that the Committee will look at that legislation and consider it favorably in terms of giving the State a clear standard of when they can impose business activity taxes and when they cannot.

Mr. Chairman, I thank you for allowing me to participate today.

Mr. BARR. I thank the gentleman from Virginia.

We also welcome to the Subcommittee's deliberations another distinguished Member of the full Judiciary Committee, Mr. Bachus from Alabama, and with unanimous consent, I would like to recognize him for 2 minutes for an opening statement.

Mr. BACHUS. I appreciate it, Mr. Chairman.

Mr. Chairman and Members of the Committee, if you poll people about what is the most important thing to them, usually education comes out first and second. They are concerned about education, they are concerned about their children getting a good education.

Now, how do we pay for our children's education, those of us like my five children who went through public schools? We pay through State and local taxes. Ninety-eight percent of the cost of public education is State and local taxes. How are those public educations delivered? What pays for them? Well, it is State and local taxes. And if you take a State like Arizona, 44 percent of the State revenues in Arizona for the State of Arizona are raised through sales tax. If you take California, 32 percent; if you take Pennsylvania, it is 31 percent; if you take Georgia, it is 35 percent. And that is the State tax. If you are talking about local taxes, over 50 percent of your local taxes are sales taxes.

What we have right now is those taxes being undermined, because more and more people are going to the Internet, and they are buying stuff off the Internet or through catalog sales. When they do that, the sales tax which the people of those States and those cities have lawfully adopted and say "We will pay," those sales taxes are not collected, and as a result, law enforcement officers, police, firemen, teachers—the money is coming right out of their pockets.

The Supreme Court said that Congress could act to remedy this. We have not acted since 1992, and in my home State of Alabama, we are beginning to lay off teachers. Our education budget is in pro ration. And in the State of Alabama, as I said, only 27 percent of our taxes are collected by sales taxes. In Pennsylvania, it is 31 percent; in Arizona, as I said, it is 44 percent.

So if you want to take money out of education, if you want to take money out of police protection and fire protection and local governments, then oppose Ernie Istook's bill, or vote against it, or put it off. But to me, it is unconscionable that this Congress continue to tell people in the State of Alabama and the State of Pennsylvania and the State of Arizona and the State of California who have passed these taxes, many of them in referendums, that we will not give them the mechanism to collect the taxes.

I will close by saying that those taxes that are to be paid are by the people in those States that have agreed to pay those taxes. We ought to give them a mechanism. Mr. Norquist has said many times that local government is the best for our dollar; it is the most efficient—not Federal Government. He has advocated closing several Federal programs and letting the States and local govern-

ments assume those programs. He is against Mr. Istook's bill, so again, as far as I am concerned, he is compromising; he is preaching one thing, but he is doing another.

Thank you.

Mr. BARR. On that positive note, we will move to the witnesses.

I appreciate very much all of the Members of the full Committee and Subcommittee being here. I appreciate the patience of our panel of witnesses.

Mr. Istook, you are certainly very familiar with the 5-minute rule, and I would urge all the witnesses, in light of the fact that we may very well be interrupted at some point or points during the proceedings with floor votes since we do have legislation on the floor, that each one of you please try to pay attention as closely as possible to the red, the yellow, and the green lights.

Also let me state for the record that your full statements and any supporting material that you would like considered as part of the official record will be so considered, so do not feel that you have to go through your entire statement; you might want to just take your 5 minutes to hit the highlights of it so we can then move on to the questions.

I am very pleased to recognize our colleague from Oklahoma, Representative Ernest Istook, for 5 minutes.

**STATEMENT OF ERNEST J. ISTOOK, JR., A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF OKLAHOMA**

Mr. ISTOOK. Thank you very much, Mr. Chairman, Ranking Member Watt, and Members of the Subcommittee.

I appreciate the chance to testify on an issue that really goes back to issues of fairness, equity, and States' rights.

Sometime soon, when we are going to be asked to vote on legislation to extend the current moratorium against Internet access taxes and against multiple and discriminatory Internet taxes, a moratorium which I support—but at that time, we also, I believe, need to consider handling the underlying problems in a manner that assures that the moratorium itself does not become a problem.

What will happen if Congress fails to enable States to establish a simplified system to collect sales or use taxes from remote sellers? The consequence will be a major shift of more power to the Federal Government, reducing the power of State and local governments. The only alternative that I foresee is that States and communities would push hard to increase property taxes and income taxes to replace the tax loss from their sales and use tax base. Personally, I find the alternative of increasing property or income taxes unacceptable.

Rather than focusing on whether to enable the States, it would be far more constructive if we were having hearings to focus on working out the details and resolve the legitimate underlying policy issues. They are not intractable; they can be resolved. But unfortunately, the reluctance of some to couple the simplification effort with the moratorium legislation is making it more difficult to resolve the details.

Nobody should have the misimpression that the Internet community or the high-tech community are united against legislation such as I am offering. Many of those in fact have joined with brick-and-

mortar merchants in groups such as the E-Fairness Coalition. Another example is the AEA, formerly known as the American Electronics Association, founded in 1943, which describes itself as the high-tech industry's largest trade association. Their over 3,500 members include all sizes and types of high-tech companies. Literally, their membership goes from A to zebra; along the way, it includes America Online, Cisco, Compaq, Hewlett-Packard, Intel, Microsoft, Motorola, Novell, Sun, and so forth. You will find all the major players and the heavy hitters of the Internet are within the ranks of the AEA.

I would like to quote to you from the AEA's 2001 Public Policy Report position paper. You can find this and their other materials on the web at aeanet.org.

I quote: "AEA does not oppose Internet taxation, but taxation, whether intentionally designed or not, that discriminates against the Internet."

"Congress should therefore pass the moratorium extension on new or discriminatory taxes on the Internet, permanently ban access taxes, and direct the States to simplify their sales tax rules. While the moratorium extension is important, it will be rendered inconsequential unless the State use the extended moratorium period to simplify and harmonize their sales tax systems. Adoption of meaningful sales tax simplification, in contrast, will give consumers and business the certainty and clarity that currently does not exist and provide a potent stimulus to the e-marketplace." End of quotation from the American Electronics Association.

As these businesses can tell you, Mr. Chairman, the current patchwork quilt is a major headache to administer. We can assist e-commerce if we assist in the simplification that brings equity and fairness and honors States' rights along with it.

There was a very unusual vote we had a year ago on May 10, when I offered an amendment focusing on the simplification issue and giving States incentive to pursue it. I offered that amendment to Mr. Cox's legislation last year, which paralleled what is before you now. The House voted to adopt my amendment 289 to 138; more than two-thirds of the Members of our body agreed that these issues need to move in tandem. It was unusual, because we had conservatives and liberals on the same side on this particular one.

As a conservative who certainly opposes higher taxes, I understand nevertheless that we have the 10th amendment, that the rights not expressly granted to the Federal Government belong to the States and the people thereof. It is their right to determine the level of their taxation. If we rob them of their ability to finance local and State government, we are undercutting the ability of State and local governments to make their own decisions—we are shifting power to Washington, D.C.

Because taxes are too high, some people automatically thumb their noses at any tax and sometimes make a Robin Hood out of people who choose to flaunt their taxes. But not everybody who flaunts taxes is doing so out of principle; many people do it out of their own personal financial interest.

The issue is not just the Internet, it is not just interstate commerce. It is federalism. It is the right to have a system where States and local governments have their own decisions. We have

the ability to permit or deny fairness and equity to come back to the system from which it has been missing.

The National Governors' Association in a bipartisan manner has called upon this Congress to enact legislation such as I propose. I am pleased that the NGA through testimony to this Subcommittee by its vice chairman, Michigan Governor John Engler, last month expressed its support for H.R. 1410, which I am sponsoring.

As Governor Engler testified: "The Governors recommend that Congress 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."

"Four out of every five States," Governor Engler testified, are willing to simplify their systems to work together to do it. They simply need the green light and the cooperation of this Congress.

Mr. Chairman, you have the remainder of my testimony in written form, and I would simply repeat that Internet merchants have long been asking for a simplified uniform sales tax system. Those that seek to comply with sales and use tax laws are indeed caught up in complexity—another type of "web" if you will. We need to assist them at the same time as we assist State and local governments so that we in Congress and in Washington, D.C. are not the only game in town, we are not the only ones that, through the power of the purse, are able to exercise Government power. We need to respect the 10th amendment and, whether we like their levels of taxation or not, respect the abilities of State and local governments by enacting legislation such as H.R. 1410.

Thank you, Mr. Chairman.

Mr. BARR. Thank you very much, Mr. Istook.

[The prepared statement of Mr. Istook follows:]

PREPARED STATEMENT OF THE HONORABLE ERNEST J. ISTOOK, JR., A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. Chairman, Members of the Subcommittee, I thank you for the opportunity to testify today on an issue of fairness and equity.

Sometime soon, the House will be asked to vote on important legislation to extend the current moratorium against Internet access taxes and against multiple and discriminatory Internet taxes. I support that moratorium. More importantly, I support the need to handle this in a manner that permanently resolves the underlying problems, and in a manner that assures the moratorium itself does not create major problems.

What will happen if Congress fails to enable states to establish a simplified system to collect sales or use taxes from remote sellers? The consequence will be a major shift of more power to the national government, reducing the power of state and local governments. The only alternative I see is that states and communities will push hard to increase property taxes and income taxes, to replace the tax loss from their sales tax base, and I find that alternative unacceptable.

Rather than focusing on *whether* to enable the states, it would be far more constructive to focus on working out the details, and resolving some legitimate underlying policy issues. Fortunately, they are not intractable issues; all of them can be resolved. Unfortunately, the reluctance of some to couple the simplification effort with the moratorium legislation is making it more difficult to resolve those details.

Nobody should have the misimpression that the Internet community, or the high-tech community, are united against legislation such as I'm offering. Many of these joined the "brick-and-mortar" merchants in groups such as the E-Fairness Coalition. Another example is the AeA, formerly known as the American Electronics Association, founded in 1943, which describes itself as the high-tech industry's largest trade association. Their over 3,500 members include all sizes and types of high-tech com-

panies. Literally, their members go from A to Zebra, along the way including America Online, Cisco, Compaq, Hewlett-Packard, Intel, Microsoft, Motorola, Novell, Sun, and so forth. You will find all the major players and heavy-hitters of the Internet within their ranks.

I quote to you from the AeA's 2001 Public Policy Report position paper, which of course you can find on their Internet website, at aeanet.org:

“AeA does not oppose Internet taxation, but taxation, whether intentionally designed or not, that discriminates against the Internet.

“Congress should therefore pass the moratorium extension on new or discriminatory taxes on the Internet, permanently ban access taxes, and direct the states to simplify their sales tax rules. *While the moratorium extension is important, it will be rendered inconsequential unless the states use the extended moratorium period to simplify and harmonize their sales tax systems.* . . . Adoption of meaningful sales tax simplification, in contrast, will give consumers and business the certainty and clarity that currently does not exist and provide a potent stimulus to the e-marketplace.” [Emphasis added.]

As they can tell you, Mr. Chairman, the current patchwork quilt of different sales and use tax provisions is a major administration headache for companies that are diligent in trying to comply fully. These businesses will benefit from the tax simplification effort contained in my bill, and its counterpart in the U.S. Senate. I urge you and all others, Mr. Chairman, to heed this solid counsel from within the Internet and high-tech industry. A moratorium, by itself, fixes nothing; instead it becomes only an excuse for perpetual delay in solving problems. Let's not pretend we've done something when all we've done is to procrastinate.

The current moratorium has created problems both because it has been misunderstood and because it has often been misrepresented. Let me hasten to add that I'm not aware of any Members of Congress who have deliberately sought to misrepresent the moratorium. So what is it that is misunderstood or misrepresented? It's the mistaken impression that the moratorium is a prohibition on the ability of states to apply their normal sales tax laws to retail sales that involve the Internet. That erroneous impression became a barrier against resolving a major problem, a problem that goes to the heart of our system of government—the rights of the states versus the rights of the federal government.

The effort to resolve this problem has created an unusual coalition, one that brought together two-thirds of this House—289 Members—on a key vote on this topic last year. That was the 289–138 vote on the amendment I offered to Mr. Cox' HR 3709 last year, which parallels HR 1552 and HR 1675 that Mr. Cox is offering this year. And the amendment I offered last year that prevailed by 289–138 is this year reflected in HR 1410, which I've authored with Mr. Delahunt of Massachusetts, and others, and which is the topic of this hearing.

Why should we assure that HR 1410 receives a floor vote, and that HR 1552 and HR 1675 should be considered only in combination with HR 1410? The answer is that 289–138 vote, which demonstrated the will of this House of Congress.

The vote was unusual because some of the most conservative and some of the most liberal House Members found themselves on the same side. Ever since then, some people have marveled at that, so let me explain it this way: As a principled conservative, I ask my fellow conservatives, “Under our Constitution, should the federal government regulate the level of state taxes? Since we desire lower taxes, would we vote to create a federal statute to cap too-high income taxes in one state, too-high sales taxes in another state, and too-high property taxes in still another? Or would we accept that these are local matters governed by the Tenth Amendment, reserving to the states, and to the people thereof, all powers not expressly delegated by our Constitution to the federal government.” Yes, Congress has the power and duty to regulate interstate commerce, but that does not give us authority to dictate state or local tax levels.

As someone who believes that taxes are too high—certainly at the federal level and very often at the state level—I still recognize that my opposition to high taxes does not justify federal usurpation of the Tenth Amendment constitutional rights of the states and their people. High taxes are a challenge at every level; but at least it's easier to hold public officials accountable at the state and local levels.

Because America's taxes are too high, some people and groups have made tax opposition their very highest priority, and that has also created some strange political bedfellows. In the eyes of some, anyone who thumbs their nose at unpopular taxes becomes a hero, even if their motive is purely to enrich themselves, not principled tax relief for everyone. Those who flaunt tax laws are not modern-day Robin Hoods; they are not taking from the rich to give to the poor. They are simply taking for themselves. Remember that at the Boston Tea Party, they dumped the tea into Bos-

ton Harbor; they didn't turn a profit on their own protest; they destroyed the tea and accepted the loss.

We have all heard the cry! "Don't tax the Internet!" What a great bumper-sticker. Nobody likes taxes. But we understand that taxes pay for roads, police and fire departments, water systems, etc. Those who simply cry, "Don't Tax the Internet!" fail to tell the rest of the story. Their full motto actually is "Don't Tax the Internet—Tax Everyone Else Instead!" I don't hear them objecting to taxes on automobiles, or restaurants, or clothing, or any other distinct sector of our economy.

Just because taxes today are too high doesn't mean it's right to ignore the need for taxes to be fair and to be equal. Remember the judge who refused to hear a complaint about unequal justice? "It's not unequal," he answered. "I treat everybody equally bad." We'll never lower taxes that are too high if we don't share the same burdens, and everyone doesn't feel the impact. Those who don't pay taxes have no incentive to help fix the problems of taxpayers.

The issue is not simply the Internet, and it's not simply interstate commerce. The issue is federalism. Just as federalism (or states' rights) is threatened when the federal government usurps decisions that should be made on a state or local level, it is likewise threatened when the federal government by action or inaction incapacitates state and local government thru the destruction of their tax base, meaning that if they want resources they must come to Washington to ask for them, and become more dependent than they already are on federal grants and appropriations. Such an environment also threatens tax competition, because if all effective taxing authority resides in Washington, it's meaningless for the states to compete by offering better, lower taxes.

Of course, for those who want higher state and local income taxes, or higher state and local property taxes, the destruction of the state and local sales tax base is a no-brainer. For the rest of us, preserving that tax base is preserving local ability to act on schools, roads, police and fire protection, public health and a host of other issues.

H.R. 1410 simply supports this federalist perspective. It permits—it does not compel—states to agree on a uniform system that is not permitted to tax Internet access and does not permit discriminatory or duplicative taxes. It simply permits fair and equal treatment for Internet and non-Internet retailers—*not a tax increase and not new taxes*.

Forty-five states including the states of Virginia and Texas currently impose sales and use taxes on the purchase of products and goods. Main Street retailers are required to collect these taxes on behalf of the states. However, Congressional inaction since the U.S. Supreme Court's *Quill* decision continues to generate confusion, because most people overlook the use tax requirements that uniformly accompany the sales tax requirements. By law, consumers who don't pay sales taxes are still required to pay use taxes. These "use" taxes exist in all 45 states that impose sales tax, and have NOT been banned either by the courts or by any Congressional bill or moratorium.

The National Governors' Association has called upon this Congress to enact legislation such as I propose. I'm pleased that the NGA, through testimony to this subcommittee by its Vice-Chairman, Michigan Governor John Engler, last month expressed its support for HR 1410. As Governor Engler testified:

"Preemption of state regulatory authority and restrictions on state revenue sources is becoming a very serious intrusion into state sovereignty. . . .

"The Governors recommend that Congress 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. . . . America's Governors support the simplifications contained in H.R. 1410, introduced by Representatives Istook and Delahunt, to reduce the burden of state and local sales tax compliance and to save the nation's economy millions of dollars by bringing our tax system into the 21st century.

"Mr. Chairman—four out of every five states are willing to simplify their systems and dramatically reduce the complexity and cost of collection for all sellers. I believe that shows our commitment to adapt to the new economy and to grow with the Internet."

HR 1410 bill enables the states to collect this tax revenue that is already due. And this is where misunderstandings creep in, and where the federal moratorium has made things worse. Whether deliberately or not, many supporters of the moratorium have created the misimpression that these use taxes are banned by the moratorium. What's worse, some have deliberately tried to spread that misinformation.

This time, it's not Congressional inaction but is Congressional action that has compounded the problems for the states.

There are growing efforts to profit from this inequity! One aspect is the growth in online sales. Monthly online sales in March were reported to be \$3.6-billion—36 percent increase from a year earlier. Another aspect is that many companies have already set-up separate e-commerce subsidiaries specifically for the purpose of avoiding sales tax. For example, I quote from one specialty publication, the E-Commerce Tax Alert Volume 1 (March 2000), which advised readers, and I quote:

“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.”

We have many examples of retail stores setting up an Internet kiosk inside their store, to provide access to their e-commerce subsidiary. Here's how one method works: A customer makes their selection in the store, then enters it into the online computer, purchases the item online without paying sales or use tax, then walks over to the counter and picks up their purchase. This is happening right now. It distorts the business sector and its normal competitive and free enterprise incentives.

Mr. Chairman, we need to level the playing field, which HR 1410 does. Not only does it provide equality of tax treatment, but also removes the artificial incentive for a merchant to seek competitive advantage not by being better businessmen, but by lowering net prices 10% or so by not requiring customers to pay sales or use taxes. Whether it's sales taxes, income taxes, property taxes, gasoline taxes or other excise taxes, anybody can drive out competition with that kind of special advantage.

That's part of equal treatment under our laws.

The bill is pro-State's Rights, but it requires states to cooperate. It gives states the ability to enter into a national compact establishing a simple and unified sales tax system. Once 20 states enter the compact, those states would have the right to require merchants who ship goods into their state to collect sales tax. That is the nexus, the place of delivery. The reason for using place of delivery, rather than place of shipment, is that the common incidence of taxation in sales and use taxes falls on the purchaser, not the seller. The seller is a collector, albeit an involuntary one—which is why states typically permit the seller's expenses for this to be subtracted from the taxes they collect, to reimburse the seller for the expense of handling the taxes. Further, to assure that this nexus is significant, the bill exempts those E-commerce merchants with under \$5 million in annual gross sales. Finally, it extends the moratorium prohibiting Internet access taxes until December 31, 2005.

Internet merchants have long been asking for a simplified uniform sales tax collection system so they don't have to deal with a patchwork quilt of different state and local tax rates. And local merchants want to be sure their Internet competitors don't get an unfair advantage by failing to collect sales taxes. Again, my bill solves this dilemma. As a strong proponent of states' rights, states should be empowered to work these problems out rather than have Congress undercut and potentially destroy state and local tax systems.

Mr. Chairman, in conclusion, when we are asked to vote on an extension of the Internet access moratorium, we should do the fair and equitable thing and include a provision that allows states to move forward in streamlining their sales tax collection.

Thank you.

Mr. BARR. I would now like to call on the distinguished gentleman, Mr. Grover Norquist.

STATEMENT OF GROVER G. NORQUIST, PRESIDENT, AMERICANS FOR TAX REFORM, AND MEMBER, ADVISORY COMMISSION ON ELECTRONIC COMMERCE

Mr. NORQUIST. Thank you, Mr. Chairman.

I served on the Advisory Commission on Electronic Commerce, and the one issue that all the commissioners could agree on was that the moratorium on access charges and discriminatory taxes on the Internet should be made permanent. I very much support Chris Cox' legislation to do so, and I have talked to all the other national taxpayer groups, and they are in agreement that that should be made permanent.

There are a couple of reasons for this. First of all, the Commerce Clause is not a loophole. It was actually a good idea; they did it on purpose. It is very important that we not allow politicians in 50 State and thousands of government to tear the national market into shreds. Congress in its wisdom passed the 4R law, which protects railroads and other industries from having every mile of track taxed by every State and local government that they go through, and protecting the Internet as we protect airlines and trucks and rails and pipelines is a good idea and should be continued.

The other is an issue that some people used to consider important, and that is the digital divide. We should have the moratorium made permanent so that we do not throw taxes on Internet access so that lower-income people have a challenge getting online. So we endorse Chris Cox' legislation and also the Goodlatte-Boucher legislation on nexus and business activities taxes as well.

What we are here to talk about as well is the effort by some politicians to hold the Internet tax moratorium hostage. People who know that this is a popular bill are trying to tack on something that is not very popular. There are a number of politicians who do not like the present Constitutional law, the Quill decision upholding the Commerce Clause; a lot of local politicians, State politicians, think it would be a very wise idea, a good idea, if they could tax people in other States. The advantage of taxing people in other States and other counties is that they cannot vote against you. It is the big government politician's dream and is exactly why Congress in its wisdom and the Constitution forbids this.

There are two arguments that we have heard raised as to why we have to allow politicians in one State to tax businesses and citizens in another State. The first is there is going to be massive revenue loss, and we have had this crisis three times. The first was under catalogs in the fifties and sixties. Catalog sales have never been more than 2 or 3 percent of sales. Sales revenues have gone up every year in every State. The catalog scare was not real.

Then, we had the services scare in the eighties—remember, everything was going to be services—no more goods produced ever again—and since sales taxes tend to be on goods, not services, we were not going to have any policy or education or firemen because of the services boom, just like the catalog boom.

Now, recently, we had the Internet boom. We are not going to have any policemen or any schools or any roads because everybody is going to buy ham sandwiches and their clothes over the Internet. And of course, the Internet is about 1 percent of sales, and I would have thought that the recent economic news would have been picked up by some of these politicians and realize that the Internet is not about to be where everybody buys their goods and services. State revenues on sales taxes are increasing, unfortunately, not decreasing, and State governments are flush with resources around the country.

The other argument we hear is the fairness argument. It is a false argument. It is if you buy \$100 worth of books in Utah, you pay \$6 in tax; if you buy \$100 worth of books from amazon.com in Utah, Utah does not under the Constitution have the right to make amazon.com collect taxes for them, so you do not pay that 6 percent tax; you simply pay \$12 shipping fees. And if the \$100 worth of

books weighs more than 5 pounds, it is \$24. On all but furniture, the shipping fees are larger than the taxes.

The fairness argument is just nonsensical and does not hold up to looking into it. And we keep hearing it, but I have suggested to Governor Leavitt and others who put this forward that if we cap sales taxes, if we never charge more than, say, \$200 on sales taxes on any amount of furniture, then the sales tax would always be lower than the shipping fees, and the problem would be solved, but it just does not give the governments, some of the governments that want more of your money, access to it.

Lastly, the question here—and it was touched on earlier. There are two views. One is States' rights—the argument advanced by George Wallace that he is allowed to do anything he wants to the people in his State. That is not where we ought to be. Ronald Reagan's federalism is where we ought to be. We want governments to compete with each other to provide the best government at the lowest cost. We do not need a milk cartel on the Internet, where we get the governments to agree that we will all cartelize like the European Union is doing to keep Ireland from having lower taxes, or one State from having lower taxes. We want the States to compete and local governments and counties to provide the best government at the lowest cost around the country, and the more competent Governors such as Governor Gilmore and Governor Swift of Massachusetts and Governor Owens of Colorado have been very clear that they want to compete, and they do not want to force other States to have higher taxes, and they do not want to try to tax people in other States.

I am coming to the end of my 5 minutes. I would simply add that privacy concerns are another reason to reject the idea of having the central government know everything you bought in your entire life, how much you paid for it, and where you physically worked and where you lived when you bought it. This strikes me as a real privacy nightmare and can certainly be avoided by extending the moratorium and not holding this hostage to some of the politicians who want to raise taxes at the State level.

Thank you.

Mr. BARR. Thank you very much, Mr. Norquist.

[The prepared statement of Mr. Norquist follows:]

PREPARED STATEMENT OF GROVER G. NORQUIST

Thank you Chairman Barr and Mr. Watt for holding this hearing today on what I believe to be one of the most important topics facing the Internet. I appreciate the opportunity to share my views before this panel and look forward to any additional questions.

Americans for Tax Reform strongly believes that we should extend the Internet tax moratorium permanently, before the October 21, 2001 deadline, put in place by an Act of Congress in 1998. In order to ensure that this new, vibrant sector of the economy continues to grow and flourish without government intrusion, Congress must act again to protect taxpayers, and you should act now.

As a member of the Advisory Commission on Electronic Commerce, I listened to the debates over this issue and had many opportunities to study all aspects of the competing arguments. The one principle that rose to the forefront was this: without an Act of Congress to protect the growth of this industry, state and local governments would levy taxes and strangle this growing sector of the economy. Indeed, before the original 1998 Internet Tax Freedom Act was signed into law, 10 states had already begun applying access charges to the Internet. Let's all take a moment to think about that—the closest thing to a revolution our economy has seen in the last decade is the growth of the Internet and e-commerce. In order to expand their cof-

fers by a few dollars, state and local governments were already working to make it more expensive for all Americans to access the Internet—in effect, ensuring that the poor were excluded from the new economy due to the nature of these taxes. These politicians were thinking of their own spending special interests—not their constituents.

Knowing that ten states began taxing Internet access in 1998 just before Congress acted, there is no doubt that should this moratorium lapse without an extension, more taxes will be applied. Without this permanent extension, bits and pieces of the Internet backbone will be taxed at different rates and across multiple jurisdictions, overwhelming companies in a sea of regulations and paperwork. Each different strand of the net that runs through various jurisdictions will be subject to hundreds of different taxes and regulations, all with the end result of trampling down this new medium and any anticipated growth. Higher costs mean that less money will be spent on this growing medium, and we will soon be facing an even larger economic slow down in the high tech industry. Rather than encouraging growth and investment, these taxes will kill the Internet.

The Internet is not unique in its use as an aid to interstate commerce. It is not the only connection between states and local jurisdictions. The railroad and airplane industries also aid traffic, sales and exports between the states. The difference between these major sales highways is that the railroad, trucking and airplane industries have been provided protection by the Constitution's Commerce Clause and the Congress from discriminatory and burdensome taxation, called the 4R law. This law protects properties owned by one of these interests from higher taxes than surrounding areas. In other words, properties owned by railroad companies where tracks are laid and switches manned cannot be taxed at higher rates than the business property adjacent to it that might be owned by a local land developer or other kind of business. Historically, railroads were owned by businesses headquartered out of state. The only presence in an area would not be a person, but would instead be a railroad track—something that obviously doesn't vote and cannot hold local officials accountable for legislating bad laws. These local representatives would go after the out-of-state railroad owner with higher taxes on the property the railroad track ran across, without the threat of being tossed out of office. Local officials had it made, until 1976 when Congress stepped in and asserted jurisdiction over interstate commerce.

Those same tactics are being seen today over the Internet. State and local governments want to tax out of state companies that provide fiber optics or telephone wires in a state, knowing that these companies will have no power to influence local lawmakers and kick them out for imposing higher taxes. It's taxation without representation and it is wrong. It amounts to a government shakedown of the Internet. These tactics hold the high tech industry hostage to state and local governments to a degree never seen before.

Additionally, the threat of mandating sales tax collection by sellers out of state is a potential burden so high that it will send companies out of business and kill online commerce. The costs imposed on companies will be sent on to consumers in higher prices for access and services, and lead even more companies to bankruptcy, destroying this new market.

Some state and local governments, rather than seeing the detriment to their constituents that these new taxes will impose, only see dollar signs. And these dollar signs include more than just sales tax revenues. Once local taxers have the names and numbers of out of state businesses, the next tax to be levied will be an out of state business income tax, followed by licensing and use fees and the threat of audits. The final straw will be the letter soliciting campaign contributions to representatives—representatives that these business interests cannot even vote for. The potential corruption and abuse of this system is staggering, and shouldn't be taken lightly.

That said, there are tech savvy politicians who understand the growth of the economy as an extension of the growth of the Internet. Politicians like Governors Gilmore, Celucci and Owens are friends of the taxpayer and friends of the Internet for their willingness to protect their constituents and businesses from additional taxation and overly burdensome regulations. Governor Gilmore especially has been a hero to the community and I was interested in his testimony at the last hearing.

Others, though, continue to peddle the phony notion that states are losing revenue on online sales and schools and hospitals are carrying the brunt of this burden. This is patently false, as it was when they first made this argument regarding catalog sales. Catalog sales have never grown over 3% and Internet sales, for all the hype and the growth of the new medium, has not grown to even 1%. There is no damage to local revenue streams, and states and locals should look to their own budgets—not the budgets of out of state businesses—for their funding. Governments

are notoriously bad at balancing their own books, but skilled at demanding fees from taxpayers because of it.

Thus losing the strength of their argument, we are left with no reason to do an end run around the Supreme Court's Quill decision. Notably, this decision did not say that state and local governments could not tax out of state sales, only that the current system was overly burdensome. State and local governments seem to know this as well—and that is why they are asking for Congress to get them out of their current predicament. The Supreme Court insisted the tax system be simplified before businesses should be burdened with the work of the local tax revenue service. Knowing this entails hard work, states and local governments have asked Congress to do the heavy lifting for them. This is irresponsible. The burden has been laid on those who crafted the myriad of laws in the first place, and they should shoulder the responsibility of any change.

For those looking for limited government, lower prices, and few taxes, the sales tax cartel is the wrong way to go. A national sales tax rate will diminish competition and provide more reasons for states and locals to apply more taxes. The current system of multiple rates keeps jurisdictions like those in southern Washington on the border of Oregon from applying even higher sales taxes than are there currently. It causes governments to think hard before applying taxes and driving consumers out of their markets. This benefits consumers and encourages spending, ultimately benefiting the economy.

Mr. BARR. Mr. Julian, you are recognized for 5 minutes, please, sir.

STATEMENT OF FRANK G. JULIAN, OPERATING VICE PRESIDENT AND TAX COUNSEL, FEDERATED DEPARTMENT STORES, ON BEHALF OF THE DIRECT MARKETING ASSOCIATION AND THE INTERNET TAX FAIRNESS COALITION

Mr. JULIAN. Thank you, Mr. Chairman.

Good afternoon. My name is Frank Julian. I am Operating Vice President for Federated Department Stores.

Mr. BARR. I want to make sure the mike is a little bit closer to make sure that the stenographer can pick you up and all of us can hear properly.

Mr. JULIAN. Thank you, sir.

Good afternoon. My name is Frank Julian. I am Operating Vice President for Federated Department Stores in Cincinnati.

Federated operates more than 450 department stores in 34 States under the names of Macy's, Bloomingdale's, Rich's, and others. Federated also has a significant direct-to-consumer presence with its Fingerhut, Bloomingdale's By Mail, and macys.com subsidiaries.

I am here today on behalf of the Internet Tax Fairness Coalition, an alliance of retail, technology, and communication companies. The ITFC firmly believes that the moratorium against new and discriminatory taxes on the Internet should be extended and that the moratorium against taxes on Internet access should be made permanent.

While there is widespread support for extending these moratoria, many have urged Congress to make collection of sales tax by remote sellers a sine qua non to extending the moratoria. We do not believe that these two issues are so intertwined that the moratoria cannot be extended without addressing the sales tax issue.

The Constitution vests in Congress the authority to regulate interstate commerce. This is a serious responsibility that Congress should not abdicate to the States. Thus, to the extent Congress is inclined to address the sales tax collection issue, we believe it is imperative for Congress to require the States to substantially sim-

plify their sales tax systems under parameters established by Congress and then for Congress to evaluate the States' simplification efforts before granting them broad tax collection authority.

The level of simplification outlined in H.R. 1410 is inadequate. In addition, by failing to have an affirmative congressional review of the States' simplification measures, this bill is calling on Congress to shirk its responsibilities under the Commerce Clause.

As noted in my written testimony, the ITFC developed a list of 19 essential simplification parameters. Of these 19 principles, however, two that are among the most important to business are the two that State and local governments have opposed most vigorously—the first, only one sales and use tax rate and base per State; and the second is bright-line nexus standards for business activity taxes. Neither of these principles is included in H.R. 1410.

I am pleased that Congressman Goodlatte and Congressman Boucher introduced a bill yesterday that does address business activity tax nexus.

The States have begun simplification efforts through the Streamlined Sales Tax Project, or SSTP. 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 that we believe are essential. Many of the SSTP simplification provisions, however, do not even become effective until 2006. In the final analysis, this proposal falls into the category of “simplification light.”

In January, the NCSL created its own version of a model act. If the SSTP's model is “simplification light,” the NCSL's version is clearly “simplification ultra-light.” As a result, there are now competing versions of inadequate tax simplification being considered by various States. For a topic in which the goal should be tax uniformity, this smacks of chaos and clearly underscores the need for congressional oversight.

Simply relying on software is not the solution. From first-hand experience, I can tell you that the software that exists today is not capable of successfully navigating the 7,600 different sales tax rates across the country or the myriad of rules imposed by those 7,600 different jurisdictions.

This Committee and others have been told that sales tax collection can be avoided if an Internet affiliate of a brick-and-mortar store places a kiosk in the store at which consumers can place orders for merchandise. This is simply not true. Under existing law, a seller that has physical presence or nexus in a State through property, employees, or agents is required to collect sales tax on all of its sales made into that State. The presence of a remote seller's kiosk in a State, whether located in a related store or elsewhere, would constitute nexus in that State for the remote seller, thus legally obligating that remote seller to collect applicable sales tax on all its sales made to customers in that State. The fact that the kiosk is located in a retail store is also likely to cause that store to become the agent of the remote seller, thus providing an additional basis for nexus.

To the extent there are remote sellers trying to take advantage of this perceived loophole, the remedy is for State revenue authori-

ties to enforce existing law. It does not require any act of Congress or of the State legislature.

If Congress is going to address the sales tax simplification issue, it must be cognizant of its responsibilities under the Commerce Clause. Congress must assure that any grant of tax collection authority to the States does not interfere with or place undue or discriminatory burdens on interstate commerce.

The tax collection authority envisioned by H.R. 1410 fails to meet this standard. Until this standard is simplified, the Supreme Court's rulings in *National Bellas Hess* and *Quill* must stand. Granting the States the power to require remote sellers to collect their sales tax should not be a condition precedent to perpetuating the positive impact the 1998 Internet Tax Freedom act has had on our economy.

Congress should act now to extend the moratorium and to permanently ban taxes on Internet access charges. Congressman Cox has introduced legislation that would do just that.

Thank you, Mr. Chairman. I look forward to the Committee's questions.

Mr. BARR. Thank you, Mr. Julian, and I know I certainly appreciate your addressing the infamous kiosk question which had come up toward the end of the last hearing. We appreciate your addressing that up front.

[The prepared statement of Mr. Julian follows:]

PREPARED STATEMENT OF FRANK G. JULIAN

INTRODUCTION

Good afternoon. 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 34 states under the names of Bloomingdale's, Macy's, Burdines, Goldsmith's, Lazarus, Liberty House, Rich's, and The Bon Marché. 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 ITFC firmly believes that the moratorium against new and discriminatory taxes on the Internet should be extended, and the moratorium against taxes on Internet access should be made permanent.

While there is widespread support for extending these moratoria, many have urged Congress to make collection of sales tax by remote sellers a sine qua non to extending the moratoria. We do not believe that these two issues are so intertwined that the moratoria cannot be extended without addressing the sales tax issue. However, to the extent Congress is inclined to address the sales tax collection issue, we believe it is imperative for Congress to require the states to substantially simplify their sales tax systems, and then to evaluate the states' simplification efforts, before granting the states the authority to require remote sellers to collect their sales tax.

The level of simplification and Congressional review outlined in H.R. 1410 is inadequate.

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 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. However, 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 United 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.

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 most vigorously: One sales and use tax rate and base per state, and nexus standards for business activity taxes. Neither of these principles is in H.R. 1410. 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

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.

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.

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.”

H.R. 1410 recommends that there be one statewide “average” tax 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

The ability of a 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 receiv-

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.

⁴ “Business activity tax” refers to tax imposed directly and not generally passed directly on to consumers. These include corporate income taxes, franchise taxes, single business taxes, cap-

ing 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.

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% 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%. 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 and representatives from state and local government are in the preliminary stages of jointly commissioning a new, independent study to determine the cost of collecting sales tax. Such a study should prove very helpful to Congress in determining the amount of collection allowance to which sellers are entitled. We are pleased that H.R. 1410 recognizes the need for such a study.

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 failure of H.R. 1410 to call for affirmative Congressional review of the states’ simplification efforts prior to approving the compact amounts to giving the foxes the keys to the henhouse.

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

ital stock taxes, net worth taxes, gross receipts taxes, use taxes and business and occupational taxes.

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 we believe are essential. Moreover, the SSTP proposals include elements of tax simplification that will be beneficial to brick and mortar sellers in collecting the tax in the states where they do business. However, many of the tax simplification provisions the SSTP has proposed are not even designed to become effective until 2006.

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.

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 in the states. According to the SSTP’s web site, as of July 13, 2001, seven⁶ states have passed some form of the SSTP’s model legislation, six states have passed the NCSL version, and three states passed some hybrid version of legislation. (A printout of this portion of the SSTP’s web site is attached as Exhibit A.)

For a topic in which the goal is tax uniformity, this smacks of chaos. The ITFC believes that Congress should establish clear criteria that will enable states to direct their efforts toward a uniform simplification plan that works for all sellers.

Congress Should Extend the Moratorium and Ban Taxes on Internet Access

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. To the extent that state and local government groups oppose the moratorium suggests

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

⁶ Of these seven, only two, Minnesota and Wyoming, adopted the SSTP Agreement, which is the piece that contains actual tax simplification. The remaining five only passed the SSTP Act, which merely manifests an intent to move forward on the project at some point in the future.

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 a permanent ban on 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 complex tax collection burdens, it could spell the end of traditional brick and mortar retail as we know it today.

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 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.

The Alleged Kiosk "Loophole"

This Committee and others have been told that sales tax collection can be avoided if an Internet affiliate of a brick and mortar store places a kiosk in the store, at which customers can place orders for merchandise. This is simply not true.

Under existing law, a seller that has physical presence or "nexus" in a state, through property, employees, or agents, is required to collect sales tax on all of its sales made into that state. The presence of a remote seller's kiosk in a state, whether located in a store with a similar name or elsewhere, would constitute nexus in the state for the remote seller, thus legally obligating that remote seller to collect applicable tax on all its sales to customers in that state. The fact that the kiosk is located in a retail store is also likely to cause that store to be the agent of the remote seller, thus providing an additional basis for nexus.

To the extent there are remote sellers trying to take advantage of this perceived "loophole," the remedy is for the state revenue authorities to enforce existing law. It does not require an overturning of the Supreme Court's decision in Quill, or any act of Congress or the state legislatures.

CONCLUSION

Congress should act now to extend the moratorium on new and discriminatory taxes on the Internet and to permanently ban taxes on Internet access charges. Granting the states the power to require remote sellers to collect sales tax should not be a condition precedent to extending these moratoria.

However, if Congress is going to address the sales tax issue, it must be cognizant of its duties under the Commerce Clause of the Constitution. Any grant of authority to the states to require remote sellers to collect their sales and use tax must insure that it 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.

H.R. 1410 fails the test of substantial simplification, and calls on Congress to shirk its responsibilities under the Commerce Clause. For these reasons, we oppose H.R. 1410.

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

STATUS OF STATE EFFORTS ON STREAMLINED SALES TAX PROJECT
(as of 8/11/01)

STATE	LEG. ADJ. ? (Y/N)	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
Alabama	N (5/14)	HB 472 and SB 321 (SSTP Act only) introduced on 02/19/01 by Rep. Lindsey and Sen. Sanders.	SB 318 have been referred to the law-writing committees. No hearings have been scheduled as legislature is currently in Special Session.		
Alaska	N (5/0)				
Arizona	N (4/17)				
Arkansas	Y	HB 2170 (SSTP Act only) introduced on 03/27/01 by Rep. Ault and Sen. HB	HB 2170 signed into law by Gov. Huckabee on 04/04/01.	Miss. Carnahan 501-662-7030	
California	N (2/14)				
Colorado	N (5/0)				
Connecticut	N (5/6)				
Delaware		NO SALES TAX			
Florida	N (5/4)	SB 1038 and HB 1328 introduced week of 03/13/01	HB 21 (incorporating provisions from SB 1438 and HB 1328) signed into law by Gov. Bush on 06/13/01.		
Georgia	Y				
Hawaii	N (5/1)				
Idaho	Y				
Illinois	N (5/22)	SB 164 (NCSL Act only) Agreement introduced by Sen. Baucusberger	SB 164 approved by Senate on 04/03/01; approved by the House on 05/29; awaits action by Gov. Ryan.		
Indiana	N (4/28)	SB 289 (NCSL Act only) introduced on 01/15/01 by Sen. Boral	SB 289 signed into law by Gov. D'Bonnin on 05/02/01.	Jim Turner 317-232-1862	
Iowa	Y	SF 409 (NCSL Act only) introduced 03/06/01 by Sen. McLaren	Legislature adjourned absent consideration of SF 409.	Carl Casafala 515-281-5560	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.

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

STATE	LEG. ADJLY (Y/N)	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
Kansas	Y (5/08)	SB 282 (Modified Act only) introduced upon recommendation of the Revenue Department and SSTR Oversight Committee.	SB 282 approved on February 14, 2001 by the full Senate; sent to the House Tax Committee for consideration; session adjourned (5/08) with no further action.	Richard Dean	
Kentucky	Y	HR 367 (SSTRP Act) introduced on 02/20/01 by Rep. Mobley	HR 367 signed into law by Gov. Frazier on 02/13/01	Charlene Quables 502-564-6943	
Louisiana	N (5/10)	HB 994 (SSTRP Act) introduced on 01/26/01 by Rep. Harrell	HB 994 signed by Gov. Foster on 02/23/01	Raymond Tangray 225-575-6947	
Maine	N (5/20)				
Maryland	Y	HB 1386 (NCSS, Act only) introduced on 02/23/01	HB 1386 approved by House on 03/16; approved by Senate on 04/04; signed by Gov. Glendening on 05/15/01.		
Massachusetts	N (Full Year)	HS323 (SSTRP Act only) introduced on 01/03/01 by Rep. Trone	Referred to the Committee on Taxation; no hearings scheduled.		
Michigan	N (Full Year)	SB433 (Modified Act only) introduced on 04/26/01 by Sen. Czernia	SB433 approved by Senate on 05/17/01	Nancy Tenke 517-341-2704	Rep. Dept. officials feel legislators will need more education on issue; lobbyist/industry meetings have been held with state relations.
Mississippi	N (5/21)	S1325 by Sen. Ford H1416 by Rep. Agramont introduced on 03/08/01 (SSTRP Act and Agreement)	Legislation approved as a part of H.P. 1 on 06/03/01; signed by Gov. Ventura on 06/30/01.	Jerry Engh 601-328-0600	Gov. Ventura held press conference on day of introduction stressing the importance of simplification; Rep. 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	Y				
Missouri	Y (5/20)	HB 603 (NCSS, Act) introduced on 02/15/01 by Reps. Bray and Gentry	Substitute bill (SB 466) approved by House on 5/5/14.		
Montana	N (5/1)	NO SALES TAX LB172 (SSTRP Act only) introduced on 01/19/01 by the Revenue Committee.	Signed by Gov. Johnson on 05/31/01.	Mary Jane Eyr 402-471-9034	LB172 made two changes to the Act—gives the Governor authority to enter into Agreement and requires publication of Agreement by the Legislature before state can participate.
Nebraska	N (5/4)	AB455 (modified Act only) introduced on 03/19/01 by Aileen Gahwiler, Cagrine & Arberry and Sen. McGinnis, Coffin and Schreiber.	Gov. Quinn signed AB 455 into law on 06/05/01.	Woody Thorne 775-667-5774	The agreement will fall under the jurisdiction of the State's referendum law. Any changes to additions, exemptions, etc. will require approval of the voters before taking effect. Thus, a major voter education effort will be required.

STATE	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
New Hampshire	NO SALES TAX			
New Jersey	N (Fall Year)			
New Mexico	Y			
New York	N (Fall Year)			
North Carolina	N (7/1)	SB 144 approved by Senate on 06/21/01; legislation now pending before House Budget Committee. SB 2465 signed by Gov. Hooper on 04/23/01.	Sally Paine 919-715-2207	Rev. Dept. holding meetings with stakeholder groups to provide education and gain support.
North Dakota	N (4/15)	SB 2485 (NCSL Act) introduced on 02/08/01 by Sen. Cook and Sen. Nething	Gary Anderson 705-325-3471 Myra Vossberg 705-325-3511	
Ohio	N (Fall Year)	SB 143 (NCSL Act) introduced by Sen. Blossing on 05/23/01	Bill Marshall 614-484-4810	
Oklahoma	N (5/28)	SB 703 (NCSL Act) introduced by Sen. Monson		
Oregon	NO SALES TAX			
Pennsylvania	N (Full Year)	HB 900 referred to Intergovernmental Affairs Committee.	Tom Armstrong 717-627-1629 or Tom Kinard 717-757-1362	
Rhode Island	N (5/3)	HB 6484 signed by Gov. Almond on 07/19/01	Bob DeLuca 401-222-3950	
South Carolina	N (5/7)	Legislation is being drafted and discussed, but introduction date not determined.	Meredith O'Leary	
South Dakota	Y	Governor signed SB 166 on 03/05/01. Legislature forms Task Force to study impact on municipalities; report due in Dec. 2001	Scott Peterson 605-773-3311	
Tennessee	N (5/3)	HB 1469 signed by Gov. Sandquist on 03/30/01.	Jack Kozick 615-741-5664	
Texas	N (5/28)	HB 1645 signed by Gov. Perry on 06/15/01.		Rev. Dept. officials holding ongoing meetings with stakeholder groups to gain support.
Utah	Y	SB 74 signed into law by Gov. Leavitt on 03/15/01.	Bruce Johnson 801-287-3301	
Vermont	Y (6/3)	Legislation referred to Ways and Means Committee.	George Phillips 802-828-2532	
Virginia	Y			

STATE	LEG. ADJ. (Y/N) (4/22)	LEGISLATION, DATE OF INTRODUCTION, AND SPONSOR	LEGISLATIVE STATUS	REVENUE DEPARTMENT CONTACT	OTHER INFORMATION
Washington	N	SCR 17 introduced to create an interim study committee to examine feasibility of Act.	05/07/01 Joint Committee on Gov. and Finance approved assigning SCR 17 to interim study committee.		
West Virginia	N (4/14)	SCR 17 and SB 152 introduced by Joint Committee on Information Policy; AB 317 introduced on 04/12/01; SB 152 introduced on 04/18/01.	SB-152 and AB-317 approved by Joint Information Policy and Technology Committee on 05/02; sent to Senate and Assembly for consideration.	Diana Heath 606-266-6796	Res Dept continuing meetings with stakeholders. Res Dept has put together talking points and information for insertion in business community newsletters—effort well received.
Wisconsin	N (Full Year)	HB259 (SBTP Act and Agreement) introduced on 01/23/01 by Rep. Hines and Sen. Peck.	HB 259 signed into law by Gov. Geisler on 05/01/01. Act will have immediate effective date, conforming amendments in Agreement have an effective date of July 1, 2002.	Johnnie Burdon/Dan Noble 207-777-5287	

Mr. BARR. Mr. Abolins, you are recognized for 5 minutes, sir, please.

STATEMENT OF JON W. ABOLINS, VICE PRESIDENT FOR TAX AND GOVERNMENT AFFAIRS, TAXWARE INTERNATIONAL, INCORPORATED

Mr. ABOLINS. Thank you, Mr. Chairman and Members of the Subcommittee.

My name is John Abolins, and I am Chief Tax Counsel and Vice President of Tax and Government Affairs with TAXWARE International. I am here today to address sales tax simplification with specific attention to the application of sales tax technology and the simplification debate.

Sales tax technology has been in existence for over 20 years and is applied successfully by thousands of merchants in every industry. This technology determines the taxing location in multistate transactions through use of the mailing addresses of the merchant and its customer. Exemption databases are searched in transactions involving specially treated products, services, entities or uses. The applicable State and local tax rates are applied, the transaction is recorded, and tax liability information is inserted into the correct space on the applicable tax return.

My company has been advising taxing authorities on the use of sales tax technology since 1998. Our efforts contributed to the technology models that several groups have proposed as components of simplification. We are currently participating in a feasibility study wherein we modified our existing, widely-used tax technology to accommodate sales tax simplification efforts and protect consumer privacy.

The implementation of existing tax software applying existing rules will not achieve the level of simplification sought by the private or public sectors. To ensure the success of sales tax simplification, four major issues must be addressed.

First, there must be uniform administration of State and local taxes. State taxing authorities must be required to provide notification of law or rule changes within sufficient time to apply them, and those relying upon such information should be held harmless if that information is not provided.

Second, State taxing authorities must create uniform definitions for specially taxed products and services.

Third, State taxing authorities should simplify exemption certificate procedures by eliminating current exemption certificate requirements. Purchasers claiming that they are exempt from sales tax should be the party required to prove that the product or service purchased was actually used for an exempt purpose. Merchants should be held harmless for granting such exemptions as long as they retain sufficient information to identify the purchaser and the product or service purchased.

Finally and fourth, State taxing authorities must adopt uniform rules for reporting and remitting sales tax liabilities. A nationwide standard for the format of a tax return is essential to simplification efforts.

Sixteen States have already enacted legislation that addresses these four subjects, and after a sufficient number of States address these four issues, merchants will be able to set up tax technology quickly, and customers of merchants using tax technology will notice no difference in their shopping experiences.

If you look at the screen before you, you will see that I have a very short demonstration. In this slide, you will see how merchants will use Internet browsers to input the mailing addresses of their sales offices, warehouses, and headquarters.

Next, merchants will associate their SKU or UPC codes with the applicable tax codes for products or services that are subject to special taxability—not those that are not subject to that special taxability.

And product codes for food and beverages are displayed before you.

This example involves the purchase of a \$1,000 stereo system by John Doe to be shipped to a shipping address in Raleigh, North Carolina. You see here that the system determines that the purchase of the stereo is subject to the 4 percent North Carolina State sales tax and the 2 percent Wake County sales tax.

This next example involves the purchase of a \$50 software application to be transmitted to the customer electronically. John Doe's "ship to" and "bill to" addresses are also in Raleigh, North Carolina. Here, you see that the system determines that no tax is due, as software that is downloaded electronically is not taxable in the State of North Carolina.

I would like to end my testimony by addressing some of the arguments against the use of tax technology that some may be familiar with.

First, the elimination of local tax rates is an unnecessary simplification, as tax technology handles local tax rates.

Further, several States plan to follow the example set by the Mobile Telecommunications Sourcing act by providing databases of all mailing addresses within their taxing jurisdictions, and merchants applying those databases will be held harmless for any inaccuracies.

Some have argued that tax technology cannot apply sales tax schemes cost-effectively. Several State and local government organizations have proposed simplifications that render sales tax schemes manageable and economically feasible. These organizations propose to compensate tax technology providers for the creation, implementation, and maintenance of sales tax systems directly at no cost to merchants.

Whenever sales tax simplification discussions involve tax technology, questions regarding its implementation into the operations of mom-and-pop merchants are always raised.

Although the de minimis standards proposed in most sales tax simplification legislation will likely obviate the need for such merchants to use tax technology, it should be noted that thousands of small merchants today who are making remote sales apply tax technology in their current business operations.

I appreciate the opportunity to present the views of my company on this important issue of public policy. We welcome future opportunities to discuss and demonstrate sales and use tax technology in greater detail.

Thank you for your attention.

[The prepared statement of Mr. Abolins follows:]

I. Executive Summary

Sales tax technology has been in existence for over twenty years, and is applied successfully by thousands of merchants in every industry. TAXWARE's current activities include the modification of our existing, widely used tax technology to accommodate the sales tax simplification efforts of the Streamlined Sales Tax Project and the National Conference of State Legislatures.

The implementation of existing tax software applying existing rules will not achieve the level of simplification sought by the private or public sectors. The lack of uniform standards for tax technology forces every business to develop a customized sales tax compliance system, even if third party tax calculation software is applied. The lack of timely tax information from government sources, the continued need to obtain valid paper exemption certificates from customers and the need to fill out hundreds of local tax returns each month represent tremendous operating costs for any merchant doing business in many states. To insure the success of sales tax simplification, four major issues must be addressed:

1. There must be unified administration of state and local taxes.
2. State taxing authorities must work together to create uniform definitions for specially taxed products and services.
3. State taxing authorities should simplify exemption procedures eliminating current exemption certificate requirements.
4. State taxing authorities must adopt uniform rules for reporting and remitting sales tax liabilities.

Many simplification proposals include a requirement that each state enact only one rate, eliminating local authority to enact the tax rate and base best suited to residents of that community. This is an unnecessary simplification, as tax technology easily handles local tax rates. Further, state taxing authorities are proposing to provide databases of all mailing addresses within their taxing jurisdictions, and will hold merchants applying these databases to assign tax rates harmless from liability for inaccuracies.

The Streamlined Sales Tax Project and National Conference of State Legislatures have proposed simplifications that render sales tax schemes manageable and economically feasible. Both organizations propose to compensate tax technology providers for the creation and maintenance of sales tax systems directly; the implementation of tax technology can be performed at no cost to merchants. The de minimis standards proposed in most sales tax simplification legislation will obviate the need for "mom & pop" merchants to use tax technology, even though thousands of small merchants making remote sales apply tax technology today.

Tax technology is a vital component to sales tax simplification. With the right level of simplification, tax technology will benefit the private and public sectors alike.

II. Testimony

Chairman Barr and members of the Subcommittee, my name is Jon Abolins, and I am Chief Tax Counsel and Vice President of Tax & Government Affairs with TAXWARE International. I am here today to address sales tax simplification, with specific attention to the application of sales tax technology in the simplification debate.

Sales tax technology has been in existence for over twenty years, and is applied successfully by thousands of merchants in every industry. This technology determines the taxing location in multistate transactions through use of the mailing addresses of the merchant and its customer. Exemption databases are searched in transactions involving specially treated products, services, entities or uses. The applicable state and local tax rates are applied, the transaction is recorded, and tax liability information is inserted to the correct space on the applicable tax return.

My company has been advising taxing authorities on the use of sales tax technology since 1998. We have met with several state and local governmental agencies and associations over the past three years, in an ongoing effort to demonstrate the capabilities of tax technology. Our efforts contributed to the technology models proposed by the Streamlined Sales Tax Project and the National Conference of State Legislatures, and we are currently participating in a feasibility study of these technology models. Our activities include the modification of our existing, widely used tax technology to accommodate sales tax simplification efforts, while concurrently ensuring the protection of consumer privacy. We are convinced that our participation in this pilot system will prove that proposed technology models are indeed feasible.

The implementation of existing tax software applying existing rules will not achieve the level of simplification sought by the private or public sectors. The lack of uniform standards for tax technology forces every business to develop a customized sales tax compliance system, even if third party tax calculation software is applied. The lack of timely tax information from government sources, the continued need to obtain valid paper exemption certificates from customers and the need to fill out hundreds of local tax returns each month represent tremendous operating costs for any merchant doing business in many states. To insure the success of sales tax simplification, four major issues must be addressed:

- First, there must be unified administration of state and local taxes. Merchants and tax technology providers should be able to obtain all necessary information from a state taxing authority. This will eliminate the need to seek out ordinances and other tax information from local taxing authorities, a sometimes impossible task. State taxing authorities must be required to provide notification of law or rule changes within sufficient time for implementation into a computer system, and those reliant upon such information should be held harmless if that information is not provided

- Second, state taxing authorities must work together to create uniform definitions for specially taxed products and services. The harmonization of existing tax bases through implementation of common definitions is a viable alternative to restricting those tax bases
- Third, state taxing authorities should simplify exemption certificate procedures eliminating current exemption certificate requirements. Today, merchants must obtain and maintain paper exemption certificates as evidence of tax-free transactions with churches, charities, and other exempt purchasers. Failure to comply with this rule can result in significant liability to the merchant. Sales tax simplification efforts must include the elimination of the requirement to obtain exemption certificates. Purchasers claiming they are exempt from sales tax should be the party required to prove that the product or service purchased was actually used for an exempt purpose; merchants should be held harmless for granting an exemption as long as they retain sufficient information to identify the purchaser and the product or service purchased
- Fourth, state taxing authorities must adopt uniform rules for reporting and remitting sales tax liabilities. Tax returns should only be filed with state taxing authorities. A nationwide standard for the format of a tax return is essential to simplification efforts

After these four issues are resolved, merchants will be able to set up tax technology quickly, and customers of merchants using tax technology will notice no difference in their shopping experiences. It is important to note that the model simplification statutes approved by the National Conference of State Legislatures and the Streamlined Sales Tax Project include provisions that satisfy these four issues, and the technology components of both versions of model legislation have already been enacted in sixteen states.

Many simplification proposals include a requirement that each state enact only one rate, eliminating local authority to enact the tax rate and base best suited to residents of that community. This is an unnecessary simplification, as tax technology easily handles local tax rates. Following the example set by the Mobile Telecommunications Sourcing Act, state taxing authorities are proposing to provide databases of all mailing addresses within their taxing jurisdictions, and will hold merchants applying these databases to assign tax rates harmless from liability for inaccuracies. If these databases are made available, the assignment of many tax rates to a mailing address could be performed cost-effectively.

Some merchants have argued that tax technology cannot fully address the myriad complexities of current sales tax schemes. Although it is an incontrovertible fact that sales tax complexity increases the costs and resources merchants and tax technology providers must allocate to create and apply sales tax compliance systems, the Streamlined Sales Tax Project and National Conference of State Legislatures have proposed simplifications that render sales tax schemes manageable and economically

feasible. Further, both organizations propose to compensate tax technology providers for the creation and maintenance of sales tax systems directly; the implementation of tax technology can be performed at no cost to merchants. These groups' proposed simplification provisions, coupled with the elimination of tax technology implementation costs to merchants, can achieve sufficient sales tax simplification.

Whenever tax technology is addressed in the context of sales tax simplification, questions regarding the implementation of tax technology into the operations of a "mom & pop merchant" are always raised. Although the de minimis standards proposed in most sales tax simplification legislation will likely obviate the need for such merchants to use tax technology, it should be noted that thousands of small merchants making remote sales apply tax technology today. Sales tax calculations are a standard component of the software that Internet retailers have applied for years.

I appreciate the opportunity to present the views of my company on this important issue of public policy. We welcome future opportunities to discuss and demonstrate sales and use tax technology in greater detail. Thank you for your attention.

III. Sales and Use Tax Technology in Action

Sales and use tax calculation software has been on the market for over twenty years, and has been applied successfully by thousands of merchants across the United States. Although some features of the technology will be unnecessary after tax simplification, the fundamental structures and processes of the system will remain the same.

Merchant Tax Data Files allow vendors to implement their use tax collection obligation by turning off taxing jurisdictions in which they have no physical presence. Merchants also input their business locations into the system, and associate their product- or service-lines with exempt product and service codes. Merchant Exemption Files

allow vendors to implement exemptions based upon receipt of a direct pay or exemption certificate.

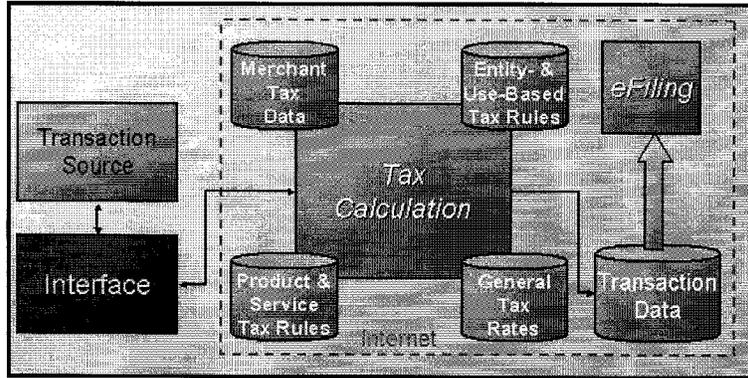
During the tax calculation process, the vendor and customer mailing addresses are compared to determine the taxing location, and the type of tax (i.e., sales or use). Exemptions are sought in the Tax Rate File, the Product Taxability File and Merchant Exemption Files;

tax calculation systems have the ability to implement both product-based exemptions, and entity- and use-based exemptions.

After transactions are calculated, the results are sent to billing applications and eCommerce billing solutions for entry onto the transaction document (i.e., invoice), and are concurrently stored in an Audit File. Automated tax return software places summary data from the audit file onto the appropriate space on the applicable tax return.

Sales Office	State/Country: NORTH CAROLINA City: BELEWS CREEK Zip Code: 27009 Geo Code: 00 County: FORSYTH
Warehouse	State/Country: NORTH CAROLINA City: BELEWS CREEK Zip Code: 27009 Geo Code: 00 County: FORSYTH
Headquarters	State/Country: NORTH CAROLINA City: BELEWS CREEK Zip Code: 27009 Geo Code: 00 County: FORSYTH

75150	Fruit juice, other than cranberry juice cocktail, containing less than 15% pure fruit juice.
75151	Fruit juice, other than cranberry juice cocktail, containing at least 15% but less than 25% pure fruit juice.
75152	Fruit juice, other than cranberry juice cocktail, containing at least 25% but less than 50% pure fruit juice.
75153	Fruit juice, other than cranberry juice cocktail, containing at least 50% but less than 70% pure fruit juice.
75154	Fruit juice, other than cranberry juice cocktail, containing at least 70% but less than 100% pure fruit juice.
75155	100% pure fruit juice, other than cranberry juice cocktail.
75156	Vegetable juice, with 100% pure vegetable juice.
75157	Vegetable juice, with at least 25% but less than 50% pure vegetable juice.
75158	Vegetable juice, with at least 15% but less than 25% pure vegetable juice.
75159	Vegetable juice, with less than 15% pure vegetable juice.



input calculate output

Customer Name: John Doe
 Invoice: 100189901 Transaction Date: July 18 2001
 Number of Items: 1 Calculation Amount: 1000

\$1,000 Stereo System

Ship To		Bill To		Same As Ship To	
Street Address 1	2001 Main Street	Street Address 1	2001 Main Street	Street Address 1	2001 Main Street
Street Address 2		Street Address 2		Street Address 2	
City	Raleigh	City	Raleigh	City	Raleigh
State	NORTH CAROLINA	State	NORTH CAROLINA	State	NORTH CAROLINA
ZIP	27601	ZIP	27601	ZIP	27601

input calculate output

Invoice Number: 100189901

Taxing Jurisdiction

State: NC
 City: RALEIGH
 ZIP Code: 27601

Tax Amounts		Tax Rates	
City	0.00	City	0.00000
County	20.00	County	0.02000
State	40.00	State	0.04000
District	0.00	District	0.00000
Country	0.00	Country	0.00000
Secondary City	0.00	Secondary City	0.00000
Secondary County	0.00	Secondary County	0.00000
Secondary State	0.00	Secondary State	0.00000

IV. The Streamlined Sales Tax Project and National Conference of State Legislatures' Proposed Technology Models

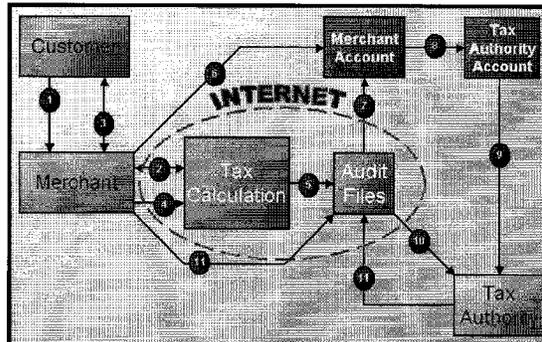
Sixteen states have to date enacted legislation that will lead to the certification of the sales and use tax calculation software merchants use to determine tax liabilities. The legislation is based upon model legislation authored by either the Streamlined Sales Tax Project or the National Conference of State Legislatures. Both versions of the model legislation include the creation of three certified technology models.

Model 1 – The Certified Service Provider

The Streamlined Sales Tax Project and National Conference of State Legislatures "Model 1" technology is defined as a system through which a "[s]eller selects a Certified Service Provider (CSP) as an agent to perform all the seller's sales or use tax functions, other than the seller's obligation to remit tax on its own purchases." The CSP will use technology to calculate, report and remit the tax liabilities for all transactions of all merchants using its service. Merchants licensing CSP services will be relieved of liability for any incorrect tax calculations unless merchant fraud is found. The CSP will be liable to taxing authorities for any incorrect tax calculations produced by the software. Taxing authorities will compensate CSPs for the performance of CSP services; the technology to be applied by merchants, including the integration of merchants' existing systems to CSP systems, will be offered to merchants at no charge.

Tax liabilities on the transactions of merchants using a CSP will be ascertained, reported and remitted in an eleven-step, automated process:

1. A customer selects products or services, and places a sales order with the merchant. The customer or order entry clerk enters all required information.
2. The tax calculation software determines the applicable tax liability and sends the calculation results to the merchant's system for presentment to the customer or placement on an invoice.



3. The customer or order entry clerk finalizes the transaction after tax liability is displayed.

4. The final tax liability is calculated. This could happen weeks after the placement of the sales order, as many merchants accept sales orders for products on that are on back order.
5. The tax information related to the transaction is stored in Audit Files.
6. The tax paid by the customer to the merchant is deposited into the merchant's account using existing practices.
7. The Audit Files are used to determine how much is tax due from the merchant to all applicable taxing authorities.
8. The information learned in step 7 is used to transfer funds from the merchant's account to all applicable taxing authority accounts. The transfer is performed using standard ACH Credit or Debit, or EFT Credit or Debit protocols.
9. The taxing authority receives a statement from their bank reflecting all deposits into the taxing authority account.
10. The CSP transmits a periodic tax return for each merchant using the service.
11. The taxing authority or merchant can use an Internet browser to review information in the Audit Files. Information can be downloaded or printed.

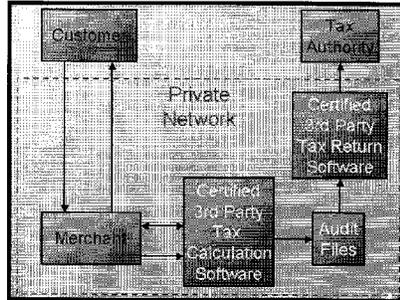
The Model 1 technology will be used in practice for the first time in mid-2001. Four states, Kansas, Michigan, North Carolina and Wisconsin, were enabled by their state governments to participate in a Streamlined Sales Tax Pilot System. The state of North Carolina issued a Request for Proposals for the creation of Model 1 technology in June, 2000, and awarded two contracts to TAXWARE International in August, 2000. To date, three merchants have agreed to process their sales and use tax liabilities through a CSP, and many more are reviewing the prospect of doing so. Pilot System revenues, costs and operations will be studied to determine whether the technology models proposed by the Streamlined Sales Tax Project and the National Conference of State Legislatures are technically and economically feasible.

Model 2 – Certified Automated Software

Many merchants do not favor Model 1 technology, as it could potentially slow transactions. Other merchants do not want their transactions processed outside of their internal computer security systems. The Streamlined Sales Tax Project and National Conference of State Legislatures created a separate technology model to avoid these issues. "Model 2" technology is defined as a system through which a "[s]eller selects a Certified Automated System (CAS) to use which calculates the amount of tax due on a transaction."

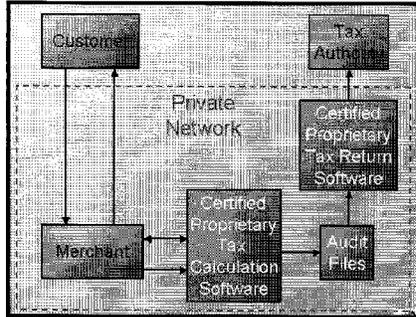
The CAS is a certified software application that is installed inside of a merchant's private computer network. The certification of transaction tax software was recommended by the Advisory Commission on Electronic Commerce, and is a component of most versions of proposed federal legislation on sales tax simplification. Merchants using a

CAS will be relieved of liability for transactions incorrectly calculated by the software, but they will remain liable for reporting and remitting transaction tax obligations to the applicable taxing authorities. Merchants will license CAS directly from the third party creators of the software; the states are currently contemplating how to compensate merchants for CAS license fees.



Model 3 – The Certified Proprietary System

The Streamlined Sales Tax Project's "Model 3" technology is defined as a system through which a "[s]eller utilizes its own proprietary automated sales tax system that has been certified as a CAS." This technology model was created to allow those merchants that have created their own tax calculation systems to enjoy some elements of certification. The level of certification will vary according to the features of the merchants' proprietary systems.



V. Recent History of U.S. Transaction Tax Simplification Efforts

The first significant group to address transaction tax simplification was the National Tax Association Communications and Electronic Commerce Tax Project. Formed in 1997, the NTA Project was an industry-state tax initiative with a goal to "develop a broadly available public report that identifies and explores the issues involved in applying state and local taxes and fees to electronic commerce." Although the NTA Project ended without agreement between the public and private sectors, it produced a report that is widely regarded as the first comprehensive document detailing the issues surrounding transaction tax simplification.

In December, 1998, three states joined forces to form the Northwest Regional Sales Tax Pilot Project. Representatives from the states of Idaho, Utah and Washington challenged industry to develop products or services that would assist in the simplification of administration of their sales and use taxes. Ensuing meetings were held with the Multistate Tax Commission, the Federation of Tax Administrators, the National Governors' Association, the National Conference of State Legislatures, the U.S. League of Cities, the U.S. Conference of Mayors, the National Association of Counties and other state and local governmental bodies. The final outcome of this series of meetings was the Zero Burden proposal rejected by the Advisory Commission on Electronic Commerce in mid-2000.

Recognizing that the Advisory Commission on Electronic Commerce would not recommend that the U.S. Congress enact the Zero Burden proposal, the Multistate Tax Commission and the Federation of Tax Administrators joined forces in early 2000 to create the Streamlined Sales Tax Project, a group that would author proposed transaction tax simplification legislation. Representatives from thirty-eight states met on a monthly bases, and in December 2000, handed off proposed legislation to the National Conference of State Legislatures' Task Force on Taxation and Electronic Commerce for review. The NCSL Task Force held a public hearing on this legislation in Washington D.C. on December 12, 2000. On January 27, 2001, the NCSL Task Force voted to substantially amend the legislation, and the NCSL Executive Committee issued a Resolution that endorsed the amended legislation the next day. On March 2, 2001, the State of Wyoming was the first state to enact streamlined sales tax legislation; Kentucky, Utah, Arkansas, North Dakota, Indiana, Maryland, Oklahoma, Louisiana, Tennessee, Nebraska, Nevada, Florida, Texas, Minnesota and Rhode Island followed. As of July 13, 2001, thirteen other states had initiated legislative efforts to enact some or all of the proposed legislation (Alabama, Illinois, Iowa, Kansas, Massachusetts, Michigan, Missouri, North Carolina, Ohio, Pennsylvania, Vermont, West Virginia and Wisconsin).

Mr. BARR. Thank you very much, Mr. Abolins.

We will now move to question the witnesses. Each one of us will have a 5-minute block of time within which to ask questions and obtain responses. If there is additional questioning by any Member after that and if time is permitting, with the indulgences of our witnesses and our work on the floor, we can certainly consider that.

I would like to at this point recognize myself for 5 minutes.

Mr. Norquist, you mentioned toward the end of your testimony something that I did not recall reading in your written testimony which caught my attention, and that is your concern over privacy matters. Could you expound on that a little bit, please?

Mr. NORQUIST. Well, if you are going to have to have a big computer system that, when you go in to buy something, knows where you live and where you are, because of different laws, and what you bought, so at the end of the day, in some central place in the

Government, there is a list of everything that you buy, how much you paid for it, where you were when you bought it, and you can track people's travels, where you live, I just think that is an awful lot of information for people to be handing over to the Government so that a Governor, instead of reining in overspending, can get an extra penny.

Mr. BARR. So are you saying that, really, one of the important questions for us to look at is to balance the need for simplification or the quest for simplification versus very, very important privacy concerns—you cannot necessarily just have simplification without giving up something, and in your view, that is a very serious privacy matter.

Mr. NORQUIST. States can simplify their tax codes any time they want. They have had these sales taxes in this country for almost 70 years in some cases, and they have been promising to simplify them and coordinate them for an awful long time, and they have not done it.

Congress does not have to do anything for the States to simplify their tax codes. They can do it tomorrow if they want to. They choose not to. They are trying to convince you to give them the power to tax out-of-State people in return for the promise to think about someday simplifying.

Simplification has nothing to do with this. They can simplify any time they want. You do not have to simplify. But there is a huge privacy danger, and those people who want some big computer program to know where you are and where you are from and what you bought need to be able to explain to the American people. I mean, this Government cannot keep track of FBI files. You are going to keep people's private purchases private?

Mr. BARR. Thank you.

Mr. ISTOOK, certainly from the many areas that we have worked together and having had discussions with you, I know that you are concerned about privacy. Do you have a reaction to that? It certainly seems to make sense the concern that Mr. Norquist has raised here.

Mr. ISTOOK. I appreciate the opportunity, Mr. Chairman.

I do not think there is anything, any proposal, that requires the Government to have access to the customer list on any sort of regular or routine or common basis of merchants. Certainly that is something that under current tax laws would require typically some sort of extraordinary showing.

I do not know of anything in the proposals for simplification that would mandate that customer lists have to become the property of Government. The Government's interest is in the overall level of sales. It is only in the instance where a seller, as I believe it was either Mr. Julian or Mr. Abolins testified—only in the instance—I am sorry—where a purchaser says that they have an exemption that the purchaser makes some sort of identification. That is what they do already, Mr. Chairman, when they claim some sort of exemption, certainly in my State, that a certification is involved, and that information is already within the province of the Government.

So I do not think there is anything about a simplified system that has to create any privacy concerns that are any greater than

those under the existing tax structure, and I think it is very important to make sure—

Mr. BARR. But which may be very great, though.

Mr. ISTOOK [continuing]. That you do not create any violations of privacy in that. But I do not think it is inherent that you would be creating any.

And I would point out, Mr. Chairman, that when you talk about the payer of the tax, the payer of the tax is the purchaser, not the seller. Yes, the seller may be involved in collecting. But the payer of the tax, the one who bears the incidence of taxation, is the purchaser under use tax laws and under sales tax laws as well. That is important because the person who pays the tax should be the one able to hold accountable the public officials who vote on legislation that would impose the taxes. A purchaser has the ability to do so, because we are talking about tax being paid on the receiving end.

Mr. BARR. But the entity that collects them has a legal obligation as well.

Mr. ISTOOK. That is correct, Mr. Chairman, a legal obligation and the right to recoup their expenses through a deduction which is a standard portion of sales tax legislation through the States. The collector withholds a set amount or a percentage amount as compensation for their work performed in collecting and remitting that tax.

Mr. JULIAN. Mr. Chairman, may I just address that last remark regarding collection? We do business in 34 States. There are 45 States plus the District of Columbia that impose a sales tax. Studies have shown that the average cost to collect that sales tax is about 3-1/2 percent. There are only 7 States right now out of the 46 that impose the sales tax—only 7 provide an uncapped collection allowance of over 1 percent. So the number of States that provide the collection allowance that Mr. Istook mentioned is very small right now. I am pleased that his bill does allow for a collection allowance and calls for a collection allowance, and we support that, but the retailers are not being compensated right now.

Mr. BARR. Thank you.

Mr. ISTOOK. And they should be compensated fairly.

Mr. BARR. Thank you.

My time is up, Mr. Norquist. If I have a little bit more time later on, I would certainly like to hear your response.

At this time, I would like to recognize the distinguished Ranking Member, Mr. Watt of North Carolina, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I think I will stay away from the privacy issue; it seems to me that that is pretty much a red herring issue. I cannot imagine that this gives any more or less—probably less—than the information that the Internal Revenue Service now collects, and I just do not think that is where we need to spend our time in this debate.

Representative Istook, Mr. Abolins has outlined four things in his testimony—do you have his testimony in front of you?

Mr. ISTOOK. I made a note of the four items.

Mr. WATT. On page 1 of his testimony, if you have a copy of his testimony, he talks about those four things. Can you tell us quickly where you think the States are now—and maybe Mr. Abolins can

help us with this—where the States are now in meeting those four objectives, because I think they are legitimate criteria that he has outlined.

Mr. ISTOOK. Certainly, Mr. Watt. I agree that they are very legitimate objectives. They are something that we have tried to make sure we take into account in H.R. 1410. It is something that was incorporated within the amendment that I offered to the moratorium legislation last year, because they are valid.

And I think what is important to understand is that the legitimate concerns that are being raised by merchants or direct marketers such as Mr. Julian—and they are legitimate—are definitely addressed in the legislation that we are sponsoring, because we agree with them that the creation of a simplified tax system should be a means to resolving the current complexity, not a means of perpetuating it.

We are trying to resolve multiple problems, including some of the current problems that remote sellers have, within the context of this legislation.

So the uniform administration, uniform definitions, and so forth that he mentions are items, actually, of agreement.

Mr. WATT. And some States have already passed legislation that gets you there. How many States have done that already?

Mr. ISTOOK. I am not certain of the current number. I was thinking 13, someone is saying 16. They have done it kind of in a phased process, because what we seek to do in the legislation is to enable States to make the actual compact. They have passed preliminary legislation, taking them one step toward the compact. They need the feedback from Congress that those are proper steps, and then they can actually finish out the final details and create the compact and create the simplification.

The problems that we have heard described from the merchants' or vendors' level are problems that would actually be resolved by our legislation. They are current problems; our legislation would help them by fixing them.

That is one of the reasons, as I mention in my testimony, that the American Electronics Association has cited its support and the need for simplification to move in tandem with the moratorium, because it will actually help to promote e-commerce by removing some of the challenges that they face today.

Mr. WATT. One of the concerns I have is that your legislation may, in my opinion, gives too long a period to do this.

Mr. ISTOOK. The 5-year—until 2006, do you mean?

Mr. WATT. Until 2006. Is it possible that this could be speeded up and done quicker than that, or are you just trying to give enough time to make sure that States do not get in a time bind?

Mr. ISTOOK. Well, I think you are right, Mr. Watt. It is not something that is set in concrete. The intent is to have the time limit that is imposed upon the States be equivalent to the time limit of a moratorium that may be enacted, and that is, frankly, one of many variables that you have in this situation, which is why I think time could be much better spent if we were talking about and working through those different variables and resolving those details rather than still being stuck at the threshold issue of whether

the tax simplification effort will be moving in tandem with the moratorium effort.

Mr. WATT. Mr. Abolins, Mr. Julian expressed concern that software has not been developed that could accurately collect taxes across the 7,600 taxing jurisdictions in the United States. I have two questions related to that.

Number one is whether that is correct in your assessment, and number two, if you did the four things that you have suggested on page 1 of your testimony, and you got to a simplified process, would you still be talking about the kind of complications that Mr. Julian believes are inherent in this process?

Mr. ABOLINS. I am sure that Mr. Julian's experience is with today's tax software, and Mr. Julian is exactly right that today's tax software has its limitations. Today's tax software implements today's tax practice which, as we all know, is extremely complicated. I can say that our software is the best on the market, but it is not going to get you an accurate tax calculation 100 percent of the time. That is precisely why my company has spent over 3 years and millions of dollars advising taxing authorities on what changes they need to make so that our tax software can give companies like Federated the accuracy that is necessary for their business operations.

And to your second question, the four topics that I presented in my testimony are those areas where I am sure Mr. Julian will agree our software struggles, because we are implementing those four areas under current tax practice. If the States simplify those four areas in accordance with the suggestions that we have given them over 3 years, then tax technology will indeed be able to get to the level of accuracy that everybody is looking for.

Mr. WATT. Thank you, Mr. Chairman. My time has expired. I yield back.

Mr. BARR. I appreciate the gentleman from North Carolina and would like to recognize the distinguished Vice Chairman of this Subcommittee, the gentleman from Arizona, Mr. Flake, for 5 minutes.

Mr. FLAKE. Thank you, Mr. Chairman.

Representative Istook, you would not end the grandfather clause for those States who tax access. Why not?

Mr. ISTOOK. I want to make sure I understand your question correctly.

Mr. FLAKE. The other two bills actually end the grandfather clause for those 10 States, I believe, that impose taxes on access. Your bill would not. Do you believe it is proper to tax access, or—

Mr. ISTOOK. No, I do not want access to be taxed, and I hope we are communicating correctly here on things—because you are speaking of a grandfather clause that permits—

Mr. FLAKE. Yes.

Mr. ISTOOK [continuing]. States currently to assess an access tax despite the moratorium.

Mr. FLAKE. Correct.

Mr. ISTOOK. I believe that is a matter of uniformity. Just as we are trying to help States to work collectively to simplify and to adopt some uniform definitions and procedures, so too, I think there ought to be uniformity on the issue of Internet access taxes,

and uniformity should be in the form of not permitting taxes that are accessed to the Internet.

I think another key on that, Mr. Flake, is because there, you are not talking about the traditional tax base of States and communities, so the very nature of any 10th amendment arguments changes. There, you are talking about access to something that is designed to be and intended to be not only interstate but international or even global in its state. You are not ordering an item to be delivered to you where you live or where you work. You are not making a purchase of an item that by its nature is going to be something that you use locally. You are making a purchase of an international, a global commodity when you purchase Internet access.

Mr. FLAKE. Mr. Norquist, you have talked about access, that taxing Internet access actually deepens the digital divide. Do you want to speak to that a little more?

Mr. NORQUIST. Well, it does. If you put additional taxes on Internet access, it makes it tougher for low-income people to have it, and there are a bunch of politicians that like to talk about the digital divide a great deal, but they do not want to give up their taxes which help create it.

Mr. FLAKE. Mr. Julian, you say that H.R. 1410 gives the foxes the keys to the henhouse. Do you want to elaborate on that?

Mr. JULIAN. Yes. By having what is called a negative trigger—in other words, under H.R. 1410 and its companion bill in the Senate, it gives prior approval to a State's compact of simplification even though, as everyone here today has said, it does not exist yet, and says that Congress has 120 days within which to disapprove of that compact.

Given my knowledge of the legislative process, I think the odds of Congress going in and disapproving that contract are virtually nil.

There is a bill in the Senate sponsored by Senator Wyden—I am not aware of a companion bill in the House—that calls for simplification and then calls for Congress to affirmatively review and evaluate the simplification and then guarantees the States and up or down fast-track vote on affirmatively approving the compact.

The simplification does not exist yet, and I guess, going back to a comment or question that Mr. Watt had about the number of States and what have they done right now toward simplification, I would invite you to look at the multicolored chart that was attached as an exhibit to my testimony, and look at it carefully. Someone in the audience said that 16 States have passed a bill—well, they have passed something, but they all have not passed the same thing. In fact, far from it—only two States, Wyoming and Minnesota, are the only two that have actually passed the SSTP agreement, which is the document that actually has the simplification. Many of these States—six of them—have passed the NCSL version of the act, which does not even call for uniform definitions let alone anything else.

Mr. FLAKE. Mr. Norquist, you have a better feel than anybody I know about the propensity of State governments to tax out there. How quickly, if the moratorium is lifted, will the States move indi-

vidually; how many after a certain period of time will be taxing, and how many will not? What is your opinion?

Mr. NORQUIST. Oh, they will just start lunging at it. I mean, in Tennessee, the Governor is trying to put an income tax in. The taxpayers have stopped him from that for 3 years. He will be at the throat of the Internet in a second. I mean, two dozen States are likely to start floating there. But there is some politician in every State that will push for it; which ones will succeed—hopefully, we can stop them all. If you guys cannot get to the moratorium extension, we are going to have an awful lot of work to do out there to stop efforts to tax the Internet.

Mr. FLAKE. Right now, States play off against each other to create a techno-friendly environment. If we lift the moratorium, what will they do to compete here, or will they, can they, compete, and does it behoove them to try to compete on that basis?

Mr. NORQUIST. One of the dangers of allowing multiple and discriminatory taxes on the Internet for Internet access is the fear that you will interfere with the national marketplace. Congress forbids State and local governments from looting railroad track lines that go through a State and having discriminatory taxes against railroad property or pipelines or airlines or trucking and so on, and that is very important to keep one national market. We had a Constitution to try to do this, a Commerce Clause to try to keep this together. And to throw away the Commerce Clause because some local elected officials want more of people's money and are not willing to vote tax increases on their own people—they want to be able to tax people in some other State—I think is a very bad mistake.

Mr. FLAKE. Thank you, Mr. Chairman.

Mr. BARR. I thank the distinguished Vice Chairman.

I would like to recognize for 5 minutes the gentleman from New York, Mr. Nadler.

Mr. NADLER. Thank you.

I am not sure who to ask this—whoever wants to take this very simple factual question. We have had a considerable change in the Internet economy since we last dealt with this question 2 years ago. Are the projections of the development of online sales equal to what they were 2 years ago, or have they dropped significantly, and what if any impact does this have on this discussion?

Mr. NORQUIST. They have dropped significantly. They were phenomenal projections that people put out, and not just silly people. A lot of people invested billions of dollars believing in those projects. And it was looking at some of those projections which I think did not make a lot of sense at the time and make no sense now and will not come to be now—and that is not where we are going—that was one of the strong arguments that some local government people said we are losing, we are going to lose all of our ability to raise sales taxes—

Mr. NADLER. So to that extent, the argument of the State and local governments is less—not nonexistent, but less?

Mr. NORQUIST. It was never good, and it is worse now.

Mr. ISTOOK. If I might address that—

Mr. NADLER. Congressman.

Mr. ISTOOK. Mr. Nadler, the most recent report that I have seen regarding the level of online retail sales was the report of the level

of sales in March of this year, which they pegged at \$3.6 billion in this report, which was an increase of 36 percent over the prior year.

Mr. NADLER. So it still increases substantially, but not at as high a rate as predicted.

Mr. ISTOOK. I think you put your finger on the key. The fact that it may not be keeping up with certain projections which were made earlier does not mean that it is not growing at an extremely fast rate.

Mr. NORQUIST. Less than 1 percent of sales.

Mr. NADLER. Mr. Istook, let me ask you—

Mr. ISTOOK. Thirty-six percent growth.

Mr. NADLER. Mr. Istook, let me ask you—

Mr. NORQUIST. Less than 1 percent of sales.

Mr. NADLER. Mr. Istook, let me ask you a question, since this may be one of the rare issues on which you and I seem to agree.

Mr. NORQUIST. You should worry about this, Senator Istook.

Mr. ISTOOK. It is an unusual issue in many ways, you are right.

Mr. NADLER. The bill that you have put before us has a 5-year extension of the moratorium and has an automatic okay of an interstate compact unless the Congress, within “x” days, vetoes an agreement. Do you think it is—well, obviously, you do, but let me ask you—why do you think it makes sense to extend this for 5 years as opposed to let us say 2 years? One of the major arguments we heard a couple of years ago is do not extend the access tax moratorium without dealing with the sales and use tax issue, because the political leverage you have to deal with the sales and use tax issue goes away if you take care of the access issue, and by extending it for 5 years—maybe we should extend it for a lesser period of time, let us say 2, to keep up the leverage to actually deal with the sales and use tax issue.

Mr. ISTOOK. What I would suggest is that the time frames should be the same. The States should have a time frame in which to act that matches the duration of the moratorium, so you do not say a moratorium is 5 years, but the States only have 2 years to act, or vice versa. It is a matter of keeping those two things in phase with each other so that the timetable match.

And what you mentioned regarding details of where you vote, for example, Senator Wyden’s bill was mentioned as far as requiring a vote. It was not mentioned that Senator Wyden’s bill, I think, requires all 50 States to enter into a compact before any State can have it. A unanimity requirement is the killer requirement; it is not very realistic.

Now, we can talk about whether it ought to be that 20 States compact together as I propose, or 26 States as somebody else proposes. Those are variables that, frankly, you can get together and reasonably figure out the levels. But I believe those are the things that we should be discussing because that is what enables us to reach some decisions.

And as far as whether you have an approval vote or a disapproval vote—we have examples of both in current legislation—the key is to make sure that congressional inaction cannot be used to block this—

Mr. NADLER. I agree with you, and that is why I like the provision in the bill that says the Congress has to act to stop the interstate compact, because I think it is essential that the States be able to not lose the ability progressively to have sales taxes if they want, or use taxes, and be able to effectuate long-distance corrections, whether it is catalog or Internet. I just worry about this bill, that maybe the length is too long to in fact have the pressure to do that, but maybe not.

Let me just ask one other question. Some people have suggested that—let us put it this way. When we talk about we do not want access taxes—I pay \$21.95, I think, to get on AOL, and I do not want that to be taxed; that would be discrimination against getting onto the Internet—although, of course, the telephone call, which is an integral part of getting onto that, is taxed, but you pay that whether you are calling your Aunt Tilly or whether you are calling to get on the Internet, so that is not a discrimination in that sense. But clearly that AOL would be an access tax. Some people have expressed the concern that in putting a moratorium, or perhaps eventually a permanent ban, on access taxes, you had better make the definitions very tight, because the courts may find all sorts of things might be access taxes—perhaps a tax on premium channels on television, or video games, or movies online. Do you have a comment on that?

Mr. ISTOOK. I think what you are describing is efforts to bundle certain items together where you buy a package rather than buying something distinct. And I agree with you that definitions are very important here, but again, let me follow the analogy that Mr. Norquist has referred to. When you talk about railroads and interstate commerce, you can equate the interstate with that, but remember that if you buy something that is shipped to you over the rails, the fact that it is shipped to you over the rails does not mean that it changes the taxability of that sale.

Mr. NADLER. That is right, although the shipper has to pay—Conrail—well, Conrail does not exist anymore—but CSX pays taxes to the State of New York on the railroad—

Mr. ISTOOK. I am talking about their customers as opposed to the railroad itself.

Mr. NADLER. Quite correct.

Does anybody else want to comment on that?

Mr. NORQUIST. Yes.

Mr. NADLER. Mr. Norquist.

Mr. NORQUIST. I think the taxpayer movement may be able to help you on this challenge. Legislation is being prepared that would extend the 4R law to all telecommunications, so it would ban discriminatory taxes by State and local governments on telecommunications, including your phone bill, cable, satellite, and so on.

Mr. NADLER. All the present taxes on the phones.

Mr. NORQUIST. Yes—well, certainly I would encourage you to abolish the Spanish American War tax, which the Federal Government imposes; but State and local government, while they have about an average of 5 or 6 percent sales tax, have an average of 15 percent excise tax on telecommunications.

Mr. NADLER. Why shouldn't we allow States to do that if they choose?

Mr. NORQUIST. Because we are trying to stop the breakup of a national market with a lot of discriminatory taxes that affect how different people communicate with each other between States—in the same way that you do not allow State and local governments to tax various parts of the railroad network and grab hold of a railroad tie and say, "We are going to charge this railroad tie a lot of money because you are going through our State."

It lowers taxes. That is the good thing about it.

Mr. BARR. If I could—

Mr. NADLER. Let me just make one thing clear.

Mr. BARR. The time of the gentleman has expired. This is a very—

Mr. NADLER. Could I have unanimous consent for one additional minute?

Mr. BARR. For 1 minute, the gentleman is recognized.

Mr. NADLER. Thank you.

Lowering taxes on the State level is a decision—lowering, raising—that is their business, and we should not tell them they should lower or raise taxes. Discrimination—discriminatory taxes, if you can establish it is discriminatory—is what I am trying to figure out.

Mr. NORQUIST. The extension of the 4R law to telecommunications would say to a State if you have a 5 percent sales tax, you can take 5 percent tax on people's phone bill, but you cannot have a 15 percent tax on phone bills and a 5 percent on everything else.

Mr. NADLER. But do we tell a State that you must have a uniform sales tax rate on—you must apply the same sales tax to purchase of a suit as to purchase of a car? We do not tell States that.

Mr. NORQUIST. No. If you do not like the idea, you can vote against it. I just think it is a pretty good idea.

Mr. NADLER. No, no. I am not trying to say I like it or not. I am saying why here—in other words—

Mr. NORQUIST. Because of the importance of telecommunications; because it crosses State lines in ways that buying suits does not.

Mr. NADLER. Okay. Thank you, sir.

Mr. BARR. I thank the gentleman.

The gentleman from California, Mr. Issa, is recognized for 5 minutes.

Mr. ISSA. Thank you, Mr. Chairman.

Just a little arithmetic, I guess, to start off my question. If we are at \$3.6 billion in Internet sales, 5 percent—does that come out to about \$180 million of tax revenue divided into all the States?

Mr. ISTOOK. If you are asking me—

Mr. ISSA. Yes.

Mr. ISTOOK [continuing]. If you are asking me, Mr. Issa, I have not done the full math. To me, the main issue is the growth rate—

Mr. BARR. Is your mike on, Mr. Istook?

Mr. ISTOOK. The switch is on at this end.

Mr. ISSA. Yes. Things are a little quiet on the mikes today.

Mr. ISTOOK. But I will speak up a little louder since the system may be having problems.

But again, it is compounding stuff—anyone who has ever dealt with when you are compounding interest or putting things on—

Mr. BARR. If the gentleman would suspend, I just want to make sure that his remarks are being picked up by the court reporter—you are picking it up okay. Okay.

Mr. ISTOOK. At a compounding rate, that is equivalent to 36 percent. That is an extremely fast rate of growth, and I think that is more important at this point—and I know that Mr. Norquist may disagree—but I think that is more important at this point than the absolute number of the sales.

Mr. ISSA. Sure. And before Mr. Norquist disagrees, maybe I will add another question. Doing my math a little further, California is about 10 percent of that, \$18 million—just our subsidy—

Mr. ISTOOK. By the way, Mr. Issa, did I mention that was a monthly rate? That is not an annual rate, that \$3.6 billion.

Mr. ISSA. Okay.

Mr. ISTOOK. That was a monthly rate of sales.

Mr. ISSA. And I appreciate that. Extrapolating that, though, \$18 million for California, and our daily subsidy for electricity for our shortfall is about \$36 million, I do not think it is going to change the educational standards in the State of California as much as every million counts even here in Washington.

One of the questions I have, though, on those figures—I used to buy books by telephone, or by filling out the little card; I used to buy records by filling out the card; I bought my radar detectors, in States where it was legal, by telephone—still have them in California. Those sales are now counted as Internet sales, aren't they, for the most part? I am now buying these things online from the same companies I used to buy them by other means.

Mr. ISTOOK. I am not aware of the particular methodology that some entities may use in measuring the sales, so I cannot tell you whether any other type of remote sale is being mixed in with that Internet number any more than I can tell you for sure that that number is accurate. We both know that there is no national mechanism for making sure you have an exact dollar volume here. We can only rely on the people who are in the business of trying to measure it.

Mr. ISSA. And maybe for Mr. Norquist—would it surprise you that as much as half of this would have been sales that formerly were done by other means?

Mr. NORQUIST. Yes. The easiest thing to buy and sell over the Internet are those things that used to be bought and sold over catalogs—computer parts and other—if you could buy it over a catalog, you can now quicker buy it over an Internet. If you wanted to go down to a local store and touch it and feel it and taste it and put it on, you could not do that over catalog, and you cannot do it over Internet.

So some local politicians get scared when people say you are going to lose a lot of revenue. Well, in point of fact, they have not lost a lot of revenue, and one of the reasons is that the Internet projections were inaccurate. The other reason is the increase in Internet sales is coming at the expense of catalog sales, neither of which, thanks to the Constitution and the Quill decision in the Su-

preme Court and the Commerce Clause, are subject to having Alabama levy taxes on L.L. Bean.

Mr. JULIAN. Mr. Issa, if I could add to clarify those numbers—

Mr. ISSA. Yes, Mr. Julian.

Mr. JULIAN [continuing]. A lot of the items that are included in those numbers are sales of things that are not subject to sales tax anyway. Securities and airline tickets are two of the most common things sold over the Internet. Neither of those items is subject to State sales tax. So I think when you are talking about trying to measure the impact on State sales tax revenue, those numbers are grossly inflated because they include items that would not be subject to sales tax under any circumstance.

Mr. ISTOOK. If I may add one more at the risk of confusing people, because it is always risky to quote one set of numbers knowing there are other people doing calculations—according to the Forrester Retail Index, I am told that they calculate in the year 2000 that retail sales—which would not be airline tickets and so forth—retail Internet sales were \$61 billion, which would be a monthly rate of approximately \$5 billion. And again, knowing the inexactness of any effort to measure this, I think we all need to consider multiple numbers and consider growth rates, not just absolute numbers. That would be higher than the numbers you had, again.

Mr. ISSA. And I appreciate that perhaps the most important thing we can note here today for this hearing is that we do not have good numbers; that maybe our friends over at Energy and Commerce should be finding a way to collect the data, which States do have, of course, because they audit the companies in each of their own States, to find out what the real sales through the Internet are, what the real growth rate is. And perhaps that is the best lesson here, that the problem appears to be manageably small today, but that getting accurate numbers could allow us in the near future to make more informed decisions.

The last answer, Mr. Norquist.

Mr. NORQUIST. Ernst & Young in June 1999 did an analysis, and they found that the quote-unquote “lost revenue” due to Internet sales was \$170 million, or one-tenth of 1 percent of sales tax in the country. And I would simply point out that politicians talk about it as lost revenue—I know where it is—it is in the pockets of people who earned it. It is not lost; it just did not get to the politicians.

Mr. ISSA. Thank you, Mr. Norquist, and I appreciate the answer that always comes to that lost revenue one.

Mr. ISTOOK. Mr. Chairman, if I may in response to Mr. Issa’s bona fide request that we have more accurate numbers, I should mention that as chairman of the Treasury, Postal Appropriations Subcommittee, one of the items in the bill which was approved at full Committee yesterday, actually, in the report is to take the U.S. Treasury Department, which has huge resources on making calculations, as you know, and research capabilities, to have them prepare those numbers for us. So that is something that as Chairman, I was able to make sure is included. Now, of course, that information will not be back to us within the next couple of months, but I have endeavored to make sure that we start putting some ef-

forts underway to get some numbers that hopefully we all can rely upon.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. BARR. Might I ask Mr. Istook if he would be amenable to sort of looking at that language and entertaining, perhaps, some amendments to it?

Mr. ISTOOK. Well, I certainly would be. It is report language. For example, I visited with Mr. Cox about it, and we are not addressing purely Internet, we are addressing remote sellers, generically.

Mr. BARR. Okay.

Mr. ISTOOK. That may be what you have in mind.

Mr. BARR. That was one concern. Thank you.

Mr. ISTOOK. Certainly.

Mr. BARR. That concludes all the Members of the Subcommittee have had an opportunity to ask questions.

I very much appreciate, and I think I can speak for the entire Subcommittee—we all appreciate very much all of your expertise in sharing your time with us today.

If there are any additional materials that any of you would like to make a part of the record, the record will remain open for 7 days, and again, the full statements that you submitted will be made a part of the record.

Thank you all very much.

This hearing is concluded.

[Whereupon, at 3:38 p.m., the Subcommittee was adjourned.]

A P P E N D I X

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Renee Giachino, *General Counsel*
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July 2001

The United States has long been considered the leader of the free-world and free-market. Over the past decade, the Internet has been a driving force in our prospering economy, despite temporary setbacks. Our country's relative economic strength in technology areas is due, in part, to the political establishment's recognition that the Internet and electronic commerce should be free from legislative and regulatory roadblocks that could impede its evolution.

Congress, in recognizing the Internet's susceptibility to creative tax schemes and the need to protect this new engine of prosperity, adopted the Internet Tax Freedom Act (ITFA) in October of 1998. It imposed a three-year moratorium on multiple, discriminatory and access taxes on the Internet.

The moratorium is set to expire in October, and the debate over its extension is being clouded by a coalition of states that fear an eroded tax base, as more consumers shop online. Some of these states are in the process of enacting model legislation that includes a "simplified and streamlined" sales tax system with the hopes of getting congressional approval to force remote merchants to collect and remit sales taxes on purchases made by their citizens.

In 1992, the Supreme Court ruled in *Quill Corp. v. North Dakota* that states, without permission from Congress, cannot require out-of-state retailers to collect and remit sales taxes unless the retailer has a substantial physical presence or "nexus" in the state.

This coalition of states, together with traditional brick-and-mortar retailers who oppose the online competition, are lobbying Congress to accept the states' "simplification" plan known as the Streamlined Sales Tax Project. In exchange, the states want permission to reach outside of their taxing jurisdictions, shifting the states' tax collection burden to remote vendors. But the "simplifications" as recommended by the Streamlined Sales Tax Project, which include a minimum of

ten categories addressing, for example, uniform rules, definitions, formats and audit procedures, are anything but simple.

First, the proposed "simplification" scheme contradicts the economic structure that has made our nation a global leader. Contrary to the view of one of our Founding Fathers, Alexander Hamilton, who noted in the Federalist No. 32 that the Constitution did not grant Congress the authority to regulate state tax policies except with regard to exports and imports, it has long been recognized that Congress has the authority, under the Commerce Clause, to regulate state taxation of interstate activities. But the primary evil that the Commerce Clause sought to remedy was attempts by states to export their tax burdens to residents of other states. Because local residents and brick-and-mortar entities benefit from state and local services and infrastructure such as police and fire protection, roads and waste collection, it is appropriate for them, and only them, to bear the tax burdens that finance such services. Based on this premise, out-of-state entities should not be forced to take on the states' responsibility and collect their taxes for them.

If current state tax systems are not adequate for the new economy, or if such systems disadvantage local retailers, states already have it within their power to collect taxes from their citizens for remote online purchases. The failure of the states to collect sales and use taxes from their citizens on such purchases is simply that – the failure of the states. But it should not be the role of Congress to provide a mechanism for states to shift their tax collection burden to out-of-state retailers. Contrarily, Congress' role should be to ensure the states do not unfairly export this burden, thereby obstructing interstate commerce.

Second, the financial burden on remote businesses to collect and remit states' sales and use taxes would ultimately result in a de facto tax increase on the consumer. As with any government mandate, especially when dealing with tax schemes, the added costs of doing business is ultimately passed on to consumers by way of increased prices.

There currently are more than 7,500 taxing jurisdictions in this country – all with different, complicated rules and structures. The proposed "simplification" does not go far enough in significantly reducing or simplifying these rules and structures to the point where businesses would not have to endure a considerable financial hardship.

Third, ironically the states' proposed method of "simplification" could reasonably be considered a violation of state sovereignty. Our country's historical framework of "no taxation without representation" led to a system of taxation that has traditionally required state legislatures to develop tax policies within their own borders. As a result, states' tax and regulatory policies employ fiscal incentives such as tax abatements and subsidies in attempting to induce non-resident firms and businesses to locate within their jurisdictions or to keep

resident businesses from moving elsewhere. Congressionally approved collusion between rival states would essentially eliminate such competition, thereby threatening our system of state sovereignty. Such lack of fiscal competition between the states would ultimately have a negative impact on consumers and our nation's businesses. Each state needs to be able to deal with its financial needs as it best sees fit.

Any simplification plan no doubt will come with conditions, such as those suggested in the 106th Congress, that allow only those states signing a compact to collect taxes on Internet commerce. This infringement on state sovereignty does not allow states or localities to give preferences to certain industries or goods or to adapt to their own particular circumstances. Congress should be cautioned against unfettered tampering with state and local fiscal schemes.

Additionally, any "simplification" program or tax collection compact between the states could conceivably require maintenance and oversight by a third party, potentially even the federal government through one of its agencies. The formation of any new bureaucracy overseen by the federal government would further threaten state sovereignty.

Even if one assumes that legislation calling for simplification would be constitutional, this approach has other pitfalls. Through growth of the Internet, expansion of e-commerce results in greater consumer options through interstate and foreign trade. Excessive regulation and taxation that may result from simplification could threaten the United States' superior fiscal position, as it could send more people to overseas vendors, ultimately exacerbating trade imbalances, as consumers in significant numbers learn to exploit currency fluctuations and direct purchase of gray market goods.

Over-regulation of the Internet will be fatal to its continued growth. As evidenced by recent court rulings in France, Germany and Italy banning content from their borders, attempts to regulate the Internet can cause national and international conflict and criticism. Individual attempts by states and countries to place burdensome restrictions on the free flow of trade over the Internet should be avoided in favor of unfettered growth of the many borderless opportunities and advantages that e-commerce provides.

Finally, the implication "simplification" would have on consumer privacy is an open question. Apart from any records that an Internet vendor may keep and use in accordance with the privacy policy that it has adopted, electronic commerce permits an Internet purchaser to maintain a level of anonymity from "big-brother" watching his or her purchasing practices. With few exceptions, the government cannot obtain vendor records without following appropriate search warrant procedures designed to protect the purchaser's fundamental right to privacy. With simplification, however, the audit procedures proffered threaten consumer privacy. The access to personal data that may result through audit

procedures leaves consumers vulnerable to misuses of sensitive information and potentially violates consumers' constitutional rights of privacy and due process. Although some proposals, such as the Internet Tax Moratorium and Equity Act (S. 512), sponsored by Senator Byron Dorgan (D-North Dakota), make passing reference to the need for appropriate protections for consumer privacy, no simplification proposal significantly addresses the issue. Simplification should not be included in any bill unless and until all potential threats to privacy and constitutional rights have been addressed.

One final and significant point is that Congress simply should reaffirm the Supreme Court Quill ruling governing states' collection of sales taxes by adopting a national, uniform nexus standard, as outlined in the New Economy Tax Fairness Act or NET FAIR (S. 664), sponsored by Senator Judd Gregg (R-New Hampshire). NET FAIR establishes a bright-line uniform jurisdictional standard for taxing electronic commerce based on the substantial physical presence or "nexus" test that would secure traditional principles of tax fairness, reinforce rate competition among the states and preserve the states' authority to set their own tax policies on commerce within their jurisdictions.

Congress can, and should, pass legislation that extends the current moratorium on multiple and discriminatory taxation on electronic commerce and make permanent the Internet access moratorium. As language often defines political battles, and in some cases wins them, the term "simplification" is anything but "simple." Congress should not include simplification provisions in the law.

The Center for Individual Freedom is a non-partisan, non-profit organization with the mission to focus attention on individual freedoms and individual rights guaranteed by the U.S. Constitution. As free-market advocates, we oppose over-burdensome state and federal regulations and taxing regimes that will impede the evolution of electronic commerce.

