# Timeline Review of Activities Related to Discussions on Internet Taxation

The Internet allows for a new business model and thus, has called into question how tax rules designed for a different model apply. Legislators, taxing agencies, businesses and tax practitioners continue discussions that began in 1996 on whether the existing tax rules and systems can apply to the new model or whether modifications or additions are needed. An added difficulty is that the new model is not firm, but continues to change, and will continue to do so as technological enhancements to Internet operations are created. Some of the interesting parts of the new business models include the fact that the Internet allows businesses to reach many customers from very few physical locations and that some products that previously were only deliverable in tangible form might now be deliverable in intangible form. Also, many businesses provide customer support via the Internet. Some businesses have also created Intranets to allow for improved internal communications and data sharing. The Internet has led to some decisions that fundamentally alter the operation of a business, such as Egghead's decision to eliminate its bricks and mortar stores and just sell software via the Internet. The ability to reach large markets from a single location can lead businesses, particularly new ones, to consider tax rules in their location decisions. For example, it has been reported that one of the reasons for Amazon.com not locating in California was that there are too many customers there and they would have to pay sales tax when buying books from an in-state company.[1] In a price-sensitive industry, whether a business is required to collect sales tax from customers is an important decision in structuring the business operations. Some of the key traits of e-commerce are highlighted in Appendix A along with a list of tax and fiscal considerations the traits present for businesses and governments. This chart also helps to illustrate the types of tax issues that arise in applying an industrial-age tax system to information-age transactions. Examples of e-commerce transactions and the tax issues they raise are presented in Appendix B.

Despite the "newness" of the business model and continuing work on identifying and understanding all of the tax issues created by it, much discussion and analysis has occurred. In addition, legislation has been both enacted and proposed to address tax concerns. Also, legal authority that predates e-commerce still serves as an important foundation for analyzing transactions and cannot be ignored. The chart below summarizes some of the significant activities that have occurred to date regarding taxation and e-commerce. The "observations" column points out issues and other considerations for each particular action related to the e-commerce taxation debate. Since a fair amount of activity has occurred, it is hoped that this timeline approach can provide a roadmap to those just getting involved in the topic, as well as serve as a review of what has occurred to date in different countries and settings.

| DATE | TYPE | DESCRIPTION | OBSERVATIONS |
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| **PRE-ELECTRONIC COMMERCE** | | | |
| 1787 | U.S. Constitution | *Commerce Clause*<br><br>"The Congress shall have power ... to regulate commerce with foreign nations, and among the several States, and with the Indian tribes." [Article I, Section 8, clause 3] | Courts often refer to the "dormant Commerce Clause" because the Commerce Clause does not specifically limit state activities—it just grants power to Congress to regulate commerce. In applying the dormant Commerce Clause, the courts consider the purpose served by the Commerce Clause and "whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve."[2]<br><br>The concern addressed by the Commerce Clause is the impact of the action on interstate commerce and the national economy, rather than the impact just to the particular taxpayer. |

[1] David Streitfeld, "Booking the Future; Does Amazon.com Show That Publishing Clicks on the Internet?" *The Washington Post*, July 10, 1998, page A1. Also see Chip Bayers, "The Inner Bezos," *Wired*, March 1999, page 115, 174. The *Wired* article notes that Amazon.com also has a warehouse in Delaware that has no state sales tax, and will open a third in Nevada to help serve its large California customer base (without having a presence in California).

[2] *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1 (1986).

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| 1868 | U.S. Constitution | *Due Process Clause*<br><br>"No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." [14th Amendment, clause 1] | "[D]ue process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."[3]<br><br>The concern addressed by the Due Process Clause is whether the law or action in question is "fair" to the particular party. |
| 1932 | State Legislation Enacted | *Sales Tax Introduced*<br><br>Mississippi became the first state to enact a sales tax. Within two years, over ten states also enacted a sales tax. Some states later repealed the tax or it expired, but they reinstated it after World War II. Most states enacted a use tax soon after adding a sales tax to the revenue base (today, all states with a sales tax also impose a use tax).<br><br>The sales tax rates in the 1930's ranged from 0.5% to 3%, which was considered high.[4] | The reason for adding the sales tax to the tax base of many states in the 1930's was the Depression. The need for revenue was the main reason for enactment. A desire to enlarge the number of people contributing to government revenues was also a reason. Opposition to the tax included its regressive nature and that merchants might have to absorb it. |
| 1959 | Federal Legislation Enacted | *Public Law 86-272*<br><br>This law provides the minimum standards that must be met in order for a state to impose a net income tax on the operations of a foreign corporation. It prohibits a state from taxing a foreign corporation's net income derived from activities within the state if those activities consist merely of solicitation of orders for the sale of tangible personal property that are approved, filled, and shipped from outside the state.<br><br>This law was enacted in response to a 1958 U.S. Supreme Court decision holding that states may tax the interstate operations of a foreign corporation if it does so in a nondiscriminatory manner and the tax is fairly apportioned to the foreign corporation's intrastate activities that show a connection (nexus) with the taxing state.[5] | P.L. 86-272 provides the guidelines for when a state may tax the *income* of a multistate business that is connected to the state. Apportionment factors that consider the amount of sales, payroll and assets a business has within the state serve to determine how much income is taxable in the state. P.L. 86-272 only applies to income taxes, and is outdated today in that it only applies to sales of tangible personal property. |
| 1965 | Congress-ional Study | *Willis Commission Report Issued in June 1965*<br><br>In the mid-1960's, Congress was studying a variety of state and local tax issues and concerns in great depth. This major study—*State Taxation of Interstate Commerce*, commonly referred to as the "Willis Report,"[6] noted the problems imposed upon states and mail order firms from the myriad taxing jurisdictions.<br><br>"Significant problems have been encountered in the application of the [sales and use] tax to interstate transactions. Viewed broadly, these problems appear to stem from a tax system which tends to divide a national market into insulated blocks of consumers, with each sales tax State erecting its own scheme for taxing consumption within its borders. ... [A] firm selling in a number of States is required to meet the peculiarities of the law in each State. If the seller is beyond the jurisdiction of the State or otherwise does not collect the tax, the sale | Many of the multistate taxation issues noted in the 1965 Willis Commission report are still with us today. Why weren't the recommendations for resolving the issues acted upon in the last 30+ years? Are the potential sales and use tax losses from the e-commerce business model enough to get states to work together to resolve the issues today? |

[3] *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 345 (1954).

[4] Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the House Judiciary, *State Taxation of Interstate Commerce* (the "Willis Commission Report"), 89th Congress, House Rpt. No. 565, 1965, pages 608 - 614.

[5] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1958).

[6] *State Taxation of Interstate Commerce*, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, June 30, 1965. Available in government depository libraries, such as at San Jose State University.

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| | | is likely to end up tax-free. For local businessmen, this raises the specter of competitive disadvantage; for the States it means a loss of revenue. All things considered, the situation appears one in which it would appear entirely possible to fashion practical solutions to practical problems."<br>The Willis Report offered suggestions, but none of the legislative proposals were enacted. | |
| May 1967 | U.S. Supreme Court Decision | *National Bellas Hess*<br>The U.S. Supreme Court had previously addressed the "minimum connection" requirement of the Due Process Clause back in 1967 in The U.S. Supreme Court issues its decision in *National Bellas Hess v. Department of Revenue of Illinois*.[7] The Court addressed the Due Process Clause issue before it by finding that some type of minimum contact was necessary for a state to tax an out-of-state business. The necessary minimum contact existed if the out-of-state company had a sales office or sales personnel in the state.<br>"The simple but controlling question is whether the state has given anything for which it can ask return." | This position held until the *Quill* decision in 1992 where the Court ruled that sales practices had changed such that a physical presence was no longer a prerequisite for due process, but continued to be for the Commerce Clause. |
| March 1977 | U.S. Supreme Court Decision | *Four-Part Test to Determine if a Tax Burdens Interstate Commerce*<br>*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) sets out a four-part test under which a tax on interstate commerce is valid if it—<br>1) is applied to an activity with a substantial nexus with the taxing state,<br>2) is fairly apportioned,<br>3) does not discriminate against interstate commerce, and<br>4) is fairly related to the services provided by the state.<br>Parts 1 and 4 serve to limit a state's ability to burden interstate commerce. Parts 2 and 3 serve to require "fair apportionment and non-discrimination" to prevent an unfair burden on interstate commerce.[8] | The four-part test of *Complete Auto Transit* is commonly sited in any case involving nexus and the Commerce Clause.<br>The "substantial nexus" requirement is not the same as the "minimum contacts" required under the Due Process Clause (per the *Quill* decision). |
| July 1985 | Federal Legislative Proposal | *Proposal to Help States Collect Sales and Use Taxes from Mail Order Companies*<br>S. 1510 (99th Congress, Andrews) proposed to enable states to collect taxes from mail order companies. The purpose was to address Congress' responsibility to the states by allowing for a method to collect tax from remote (non-present) vendors and to promote competitive equality for all businesses. | The sponsor noted that the volume of mail order sales increased from millions of dollars in the early 1960's to $60 billion in 1984. The anticipated growth of e-commerce raises perhaps even greater concerns than existed for mail order sales in 1985. |
| January 1989 | U.S. Supreme Court Decision | *How Much Physical Presence?*<br>*Goldberg v. Sweet*, 488 U.S. 252 (1989), addressed whether the Illinois telecommunications excise tax on interstate calls that originated or terminated in the state and were charged to an Illinois service address was permissible under the Commerce Clause. In deciding that such a tax was permissible, the Court noted: We doubt that States through which the telephone call's | The conclusion reached in this case may also be relevant to any tax applied to a customer's purchase of Internet access services because such a service involves signals being sent through many states. The Court found that it was permissible for a state to tax an interstate call that originates or terminates in the state if |

[7] *National Bella Hess .v Department of Revenue of Illinois*, 386 U.S. 753 (1967).
[8] As explained in *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

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| | | electronic signals merely pass have a sufficient nexus to tax that call. See *United Air Lines, Inc. v. Mahin*, 410 U.S. 623, 631 (1973) (State has no nexus to tax an airplane based solely on its flight over the State); *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 302-304 (1944) (Jackson, J., concurring) (Same). We also doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call." | the call is billed or charged to a service address or paid by an addressee within the state. |
| May 1992 | U.S. Supreme Court Decision | *Commerce Clause in the Modern Era of Mail Order*<br><br>*Quill Corporation v. North Dakota*[9] involved a seller of office equipment and supplies (Quill), a Delaware corporation, with offices and warehouses in Illinois, California, and Georgia. Quill did not have any property or employees in North Dakota. Quill mailed catalogs to North Dakota customers and advertised in national magazines. Under North Dakota law, Quill was required to collect use tax because it was engaged in regular solicitation of customers in the state. Quill challenged the North Dakota law as violating both the Due Process Clause and the Commerce Clause of the U.S. Constitution.<br><br>North Dakota challenged the 1967 *Bellas Hess* ruling as being out of date with today's ways of conducting business. Today, a company doesn't need a salesperson in a state to obtain a sale. Instead, a catalog and a mail-order sales system can be just as successful for a company. The taxing authority in North Dakota pointed out that $1 million of Quill's $200 million of sales were to 3,000 customers in North Dakota. Quill was also the sixth largest supplier of office supplies in the state. North Dakota also argued that it had created an economic climate that helped Quill's sales, that it maintained a legal infrastructure to protect the market, and that it had to dispose of 24 tons of catalogs and other mail that Quill sent into the state each year. Per North Dakota, all of this created the requisite minimum connection to enable it to collect use tax from Quill without violating the due process clause of the U.S. Constitution.<br><br>North Dakota was partially successful in its argument that the *Bellas Hess* nexus standards for sales and use tax purposes were outdated. The Court stated that its earlier tests were too formalistic and that for Due Process purposes, it would be more appropriate to not focus on physical presence, but to instead look at whether the company's contacts with the state make it reasonable for the state to require the company to collect use tax. In *Quill*, the Court stated that if an out-of-state business purposefully avails itself of the benefits of an economic market in the state, it need not have a physical presence in the state to be subject to tax collection requirements in the state.<br><br>Despite the Court's relaxation of the due process physical presence requirement, the Court stated that North Dakota's enforcement of the tax against Quill was an unconstitutional burden on interstate commerce in violation of the Commerce Clause. However, the Court pointed out that because the Constitution gives Congress the right to regulate interstate commerce, Congress could provide a mechanism to allow states to collect sales and use tax from an interstate mail-order business that was not physically present in the state, without violating the Commerce Clause. | The *Quill* decision is the reason why remote mail order companies and Internet vendors do not collect use tax on orders shipped to states in which the vendor does not have a physical presence. The Internet Tax Freedom Act (enacted in October 1998 and discussed later), in most situations, does not impact whether a remote vendor is to collect sales and use tax from vendors.<br><br>A few years after the *Quill* decision, legislation was introduced in Congress by Senator Bumpers to require mail-order companies to collect use tax under certain circumstances. However, the legislation was not enacted (see later description). |
| January 1994 | Federal Legislative | *Legislation in Response to the* Quill *Decision* | Senator Bumpers reintroduced his legislative proposal in the 104$^{th}$ Congress (S. 545) and the 105$^{th}$ Congress (S. |

[9] *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

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| | Proposal | S. 1825 (103d Congress, Bumpers) is introduced in response to the Supreme Court's comment in the Quill decision that Congress can resolve the Commerce Clause issue to enable states to collect sales and use taxes from remote vendors. This legislative proposal would have authorized States to require persons subject to the State's personal jurisdiction to collect and remit sales tax with respect to tangible personal property under the following circumstances:<br>• The vendor delivers tangible personal property into the State.<br>• The vendor has gross receipts from sales of the property in the U.S. in excess of $3 million, or sales in the State in excess of $100,000.<br>• The State collects the local sales tax for its local jurisdictions.<br>• The State does not require the vendor to file returns more than once per quarter.<br>• The State sets up a toll-free information service to provide vendors with information and forms.<br>Senator Bumpers notes that the states lose over $3 billion annually through their inability to have remote vendors collect sales tax. | 1586). Reasons why this legislation has not been enacted include the retirement of Senator Bumpers and the fact that some states collect the use tax by including a line for it on the state income tax return. Today, such legislation is on hold while a federal commission studies taxation of e-commerce, while presents many of the same issues as do mail order sales (discussed later).<br>This legislation is not without flaws. Additional rules would be needed to define terms used, such as tangible personal property. (For example, some states include software delivered electronically as tangible personal property, while others view it as intangible.) Also, state and local governments would need to modify their systems to allow for a single rate and some mechanism for the state collection to be distributed to local governments. |
| May 1994 | U.S. Supreme Court Decision | *Discriminatory Tax Violates the Commerce Clause*<br>In *Associated Indus. of Missouri v. Lohman*, 511 U.S. 641 (1994), the Supreme Court found that a local tax structure that sometimes imposed a higher use tax (interstate) than sales tax (intrastate) was found to impermissibly discriminate against interstate commerce and was struck down. | Some people have suggested that e-commerce transactions be subject to a separate sales tax, or perhaps to no sales or use taxes. Arguably though, this would violate the Commerce Clause because the rates would most likely be different. Even if e-commerce sales are not taxed, this rate of zero differs from the rate applied to in-state purchases. |
| March 1995 | Federal Legislative Proposal | *Legislation in Response to the* Quill *Decision*<br>Senator Bumpers introduces S. 545, the Consumer and Main Street Protection Act of 1997, to enable states to collect sales taxes from remote vendors. (See earlier description of S. 1825). | See earlier description of S. 1825. |
| April 1995 | U.S. Supreme Court Decision | *Sales and Use Tax on Interstate Travel*<br>*Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995), held that Oklahoma's imposition of sales tax on an interstate bus ticket for trips originating in Oklahoma did not violate the Commerce Clause, even though part of the trip took place outside of the state. The Court noted that historically no apportionment of the tax base was required for sales and use taxes because a "sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed." The tax passed muster under the second prong of the Complete Auto test because if every other state imposed an identical tax, no double taxation would result. Also, the tax was not found to reach "beyond the portion of value that is fairly attributable to economic activity within the taxing State." | In December 1995, P.L. 104-88, the Interstate Commerce Commission Termination Act was enacted. This Act included a provision (§14505) that, in effect, overrode the *Jefferson Lines* decision. Under the Act, no state or political subdivision may collect or levy a tax, fee, head charge, or other charge on a passenger traveling in interstate commerce by motor carrier, or on the transportation, or the sale of passenger transportation in interstate commerce by a motor carrier, or the gross receipts derived from such transportation. This Act is an example of Congress's power under the Commerce Clause.<br>Some people have suggested that this case supports imposing sales tax on services provided over the Internet based on where the service provider provides the services (an "origin" approach, rather than a |

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| | | | "destination" approach).[10] |
| **ELECTRONIC COMMERCE ERA** | | | |
| July 1995 | Business Activity | *Amazon.com Begins Business*<br><br>Bookseller Amazon.com begins business without a bricks and mortar store. All sales are placed through the company's web site. | Amazon.com is a good example of the new business model that e-commerce allows. Amazon.com is less than five years old and has just six physical locations in the U.S. Yet, Amazon.com has customers in over 160 countries. |
| December 1995 | Multistate Tax Commission | *Release of "National Nexus Program Bulletin 95-1"*<br><br>This bulletin states that the computer industry practice of using third party in-state warranty repair service providers creates nexus for use tax collection purposes. Also, for income tax purposes, the MTC states that providing warranty repair work exceeds solicitation and it not a protected ancillary activity and is thus not protected by P.L. 86-272. The Bulletin states that it applies in 26 specified states. The list includes California.<br><br>In 1996, both the California State Board of Equalization and Franchise Tax Board voted to not follow Bulletin 95-1. | Bulletin 95-1 is an example of the problem of trying to reach uniformity of definitions among the states. While not all states belong to the MTC, the MTC was not ultimately even able to get consensus among its members, as evidenced by California declining to adopt the position of the bulletin. Many commentators viewed 95-1 as an overly aggressive interpretation of case law dealing with agency and nexus. Again, this does not bode well for prospects of industries and governments working together to resolve nexus issues. |
| October 1996 | German Supreme Tax Court Decision on PE | *German Ruling on PE May Have Significance to Internet*<br><br>The Second Chamber of the German Supreme Tax Court ruled that an unmanned underground pipeline owned and operated by a Dutch company constituted a permanent establishment (PE) in Germany. The tax involved as a net worth tax, rather than an income tax.[11] | Would an extension of the logic supporting this ruling mean that servers and telecom wires create a PE in a country?<br><br>In November 1998, German tax authorities announced that a server does not crate a PE.[12] |
| November 1996 | Report of the Federal Government | *U.S. Treasury Department Paper*<br><br>In late 1996, the Treasury Department issued a report[13] to provide an "introduction to certain income tax policy and administration issues presented by developments in communications technology and electronic commerce." The paper does not make any conclusions; instead, it raises issues and encourages interested parties to submit both overall and specific comments on the topics, problems and issues identified in the paper. The paper was intended to stimulate public discussion on the issues it addresses. The paper presents a background to the Internet and the types of transactions that currently occur on it, as well as those that may occur in the future, such as settling stock trades electronically, and offshore banking. The paper also provides some introductory information on encryption and electronic money systems. | This was the first paper by a government to raise and discuss some of the possible issues of applying tax rules to e-commerce transactions. Some other countries later did the same. One of the controversial points of the paper stated: "Transactions in cyberspace will likely accelerate the current trend to de-emphasize traditional concepts of source-based taxation, increasing the importance of residence-based taxation." Subsequent discussions have indicated that for many transactions, existing tax rules likely can continue to apply. Also, given that so many e-commerce businesses are resident in the U.S., this portion of the Treasury statement was not well received among other countries. |

[10] Arthur Angstreich, James R. Fisher, and Eric J. Miethke, "*Jefferson Lines* as Ticket to Cyberspace? Taxing Electronic Commerce Services," *Tax Notes,* July 27, 1998, page 499. Also see Terry Ryan and Eric Miethke, "The Seller-State Option: Solving the Electronic Commerce Dilemma," *State Tax Notes*, 98 STN 192-23 ((10/5/98).
[11] Friedrich E.F. Hey, "German Court Rules Remote-Controlled Pipeline Constitutes a PE," 97 TNI 36-21.
[12] Friedrich E.F. Hey, "German Tax Authorities Rule that Server Does Not Constitute PE," 1999WTD 153-1.
[13] *Selected Tax Policy Implications of Global Electronic Commerce*, by the U.S. Treasury Department (Nov. 21, 1996), http://www.ustreas.gov/taxpolicy/internet.html.

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| March 1997 | Federal Legislative Proposal | *Internet Tax Freedom Act First Introduced*<br>H.R. 1054 (Cox) and S. 442 (Wyden) were introduced in the 105th Congress. Much discussion, debate and modification occurred over the next 18 months. See later entry for October 1998 for information on the enacted legislation. | This legislative proposal appears to be the beginning of people really thinking about taxation of Internet access fees and goods sold over the Internet. The ultimate legislation only provided a very narrow moratorium on Internet access fees and multiple and discriminatory (very narrowly defined, see Appendix C) taxes. |
| July 1997 | Report of Federal Government | *Internet Taxation Guidelines from the White House*<br>A paper issued by the White House covers various legal and operational aspects of global electronic commerce.[14] With respect to taxation and customs issues, the framework provides:<br>• The U.S. will advocate that the Internet be declared a tariff-free zone when used to deliver products or services.<br>• No new taxes should be imposed on Internet commerce.<br>• Taxation of e-commerce should follow current principles of international taxation, should avoid double taxation, and be simple to administer and easy to understand.<br>• Taxation of e-commerce should not hinder commerce and consist of a system that can accommodate both U.S. tax systems and those of other countries.<br>• Guidance should be based on existing tax concepts and principles, wherever possible.<br>• Any tax system applicable to e-commerce must address its special characteristics—possible anonymity of the parties, small transactions, and difficulties of trying to identify non-physical transactions with a physical location.<br>• The U.S. should work with the OECD to help achieve global consensus on taxation of e-commerce.<br>• The above principles should be applied not only in the international context, but also at the subnational levels.<br>• "Before any further action is taken, states and local governments should cooperate to develop a uniform, simple approach to the taxation of electronic commerce, based on existing principles of taxation where feasible."<br>In November 1998, the Administration issued the First Annual Report of the U.S. Government Working Group on Electronic Commerce, noting the progress that had been made on the framework and introducing some new initiatives, such as ensuring adequate bandwidth and access, and assisting small businesses in effectively using the Internet.[15] | As with the 1996 Treasury report, the White House report helped set the tone and pace of activities by the OECD and other countries.<br>The emphasis on the need to ensure that the growth of e-commerce is not impeded so that it can reach its full potential for the benefit of the economy has been a focal point in positions of many governments and industry groups.<br>These initiatives of the White House - increasing bandwidth and getting more businesses on the Internet will impact state and local sales tax bases. For example, it will be easier to transfer digitized products, such as books and music, which in some states (such as California) are not subject to sales tax. |
| 1997 - 1999 | Reports and Discussions by the OECD, EU, Australia, Canada, | *Other Countries Follow U.S. Lead and Issue Discussion/Background Papers*<br>The OECD, Australia, Canada, the European Union and a few other countries have issued extensive reports similar in concept and approach to the U.S. Treasury and White House papers.[16] Common themes include,<br>• The Internet and e-commerce present opportunities for both governments and businesses. | While the papers of Canada, Australia and Ireland are over 100 pages long, they are highly recommended reading for obtaining a more specific overview to the variety of e-commerce taxation issues and the ideas trading partners have about how to address them. Some of the papers also include information on technological |

[14] Available on the Internet at http://www.whitehouse.gov/WH/New/Commerce/.
[15] Available at http://www.ecommerce.gov/.
[16] Links to these papers can be found at http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html.

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| | Ireland | • New taxes should not be imposed because restricting development of the Internet and e-commerce will only harm the country's economy.<br>• Neutrality should be considered in applying tax laws to transactions in e-commerce so that the tax law does not distort behavior.<br>• Multiple taxation must be avoided.<br>• Tax systems should be simple in order not to hinder a business's expansion of its market into the large markets offered through e-commerce.<br>• Countries will need to work together to deal with tax issues so as to avoid multiple taxation, undue competition, updating and coordinating treaty provisions, coordinating the legal basis for taxing multinational transactions, and coordinating enforcement powers.<br>• Governments and taxpayers should work together to identify and address issues. | aspects of Internet and e-commerce transactions, and non-tax considerations. |
| November 1997 | Examples of State Activity to Clarify Nexus for Internet Activities | *Redefining Nexus to Address Web Pages and ISPs*<br>The State Board of Equalization modified Reg. 1684 dealing with whether a retailer is engaged in business in the state, such that it must collect sales and use tax from customers, by adding the following:<br>"The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, Internet work communication service provider, or other Internet access provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state." | This modification provided better certainty for retailers.<br>This change made California's Internet Tax Freedom Act less relevant than might be considered. Reg. 1684 already provides that using services of an ISP or having a web page that can be displayed in a state do not create nexus. The California ITFA provides the same effect. |
| November 1997 | Discussion by OECD | *First Government-Industry International Conference on Internet Taxation*<br>A conference entitled, "Dismantling the Barriers to Global Electronic Commerce" was held in Turku, Finland. | |
| November 1997 | Government-Industry Cooperation | *Voluntary Agreement to Collect Use Tax Under Simplified System Falls Apart*<br>The Direct Marketing Association attempted to enable its members to enter into voluntary collection agreements (VCA) with certain states. Under the agreement, the companies would collect use tax, but under a simplified system that included standardized tax forms and exemptions, quarterly rather than monthly tax remittances, simplification in rates in that they could not be changed more frequently than quarterly and would have to apply based on 5-digit zip code, and possible waiver of liability for back taxes.<br>After a story about the possible agreement appeared in the New York Times (11/6/97), some of the large mail-order companies received calls from angry customers and the VCA fell apart.[17] | It is interesting to note that some states were willing to compromise by simplifying their tax systems in order to get companies to voluntarily collect use tax. Similarly, companies that might potentially be found to have nexus or who wanted to collect use tax but with reduced collection costs were willing to compromise with the states. The fact that the VCA was partly ended due to customer complaints indicates that the states need to do a much better job of educating its residents about the use tax. |
| January 1998 | Legislative | *Legislation in Response to the* Quill *Decision* | See earlier description of S. 1825. |

[17] David CayJohnston, "Deal to Close Mail-Order Tax Loophole Said to Be Imminent," *New York Times*, 11/6/97; and "Direct Marketing Talks on Hold," *Tax Administrators News*, November 1997, page 90.

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| | Proposal | Senator Bumpers introduces S. 1586, the Consumer and Main Street Protection Act of 1997, to enable states to collect sales taxes from remote vendors. (See earlier description of S. 1825). | |
| May 1998 | International Trade Agreement | *World Trade Organization (WTO) Issues Declaration on Global E-Commerce*<br><br>The agreement declares that the WTO members will continue their current practice of not imposing custom duties on electronic transactions, but that such agreement will be reviewed at a later date. | Will this moratorium be permanent or temporary? How would custom duties effectively be applied to items that don't physically cross the border? |
| August 1998 | California Legislation | *California Moratorium*<br><br>The CA-ITFA (AB 1614; Chapter 351; 8/24/98) imposes a 3-year moratorium to prevent any city, or county, or city and county from assessing taxes on Internet access, on-line computer services, or the use of Internet access or any on-line computer service; a bit tax or bandwidth tax;[18] or any discriminatory tax on Internet access or on-line computer services. The prohibition does not apply to any new or existing tax of general application that is imposed or assessed in a uniform and nondiscriminatory manner without regard to whether the activities or transactions taxed are conducted through the use of the Internet, Internet access, or Online Computer Services. Thus, sales and use taxes, business license taxes, utility user taxes generally continue to apply. If the FCC finds that Online Computer Services or Internet access delivered over a cable television system are not cable services, a cable television franchise fee may not be imposed on such services.<br><br>"It is the intent of this Legislature that no existing or future state taxes or state fees be imposed by the state in a discriminatory manner upon Internet access or Online Computer Services. This statement of legislative intent is meant to place the greatest possible barrier to the creation of discriminatory taxes or fees upon this Legislature and all future Legislatures." | Why—"Taxes imposed on Internet access or Online Computer Services by state and local governments could subject consumers, businesses, and other users engaged in interstate and foreign commerce to multiple, confusing, and burdensome taxation, could restrict the growth and continued technological maturation of the Internet itself, and could call into question the continued viability of this dynamic medium. This could threaten Internet access for Californians at home, at work, and at school, and is counterproductive to established state policies, such as the promotion of telecommuting." [from AB 1614] |
| September 1998 | OECD | *Revision of Article 12 Commentary on Software Payments*<br><br>The OECD's Committee on Fiscal Affairs released changes to the OECD Model Tax Convention with respect to characterization of software transactions. The rationale for the release is that similar rules might be appropriate for e-commerce transactions involving digitized products which the OECD and others were presently studying. The commentary calls for characterizing the payments received based on the nature of the rights acquired by the transferee. The treatment as either royalties (where rights to the copyright are involved) or commercial income (where the transferee obtains use of the copyrighted item), is similar to the treatment provided in Reg. §1.861-18 (see below). | |
| October 1998 | Federal Legislation | *Federal Moratorium and Advisory Commission*<br><br>The Federal Internet Tax Freedom Act (ITFA, P.L. 105-277, 10/21/98) imposes a 3-year moratorium (from 10/1/98 through 10/21/2001) on state and local taxes on Internet access, unless such tax was generally imposed and actually enforced before October 1, 1998. The moratorium also applies to multiple or discriminatory taxes on e-commerce. Exceptions: (1) persons or entities who knowingly communicate via the Web in interstate or foreign commerce for commercial purposes, materials that is harmful to minors (with some exceptions), (2) | Despite the "tax freedom" reference in its title, various taxes are still imposed on transactions involving use of the Internet. The F-ITFA specifically preserves state and local taxing authority that is otherwise permissible. Thus, a California resident purchasing taxable goods over the Internet from a vendor not subject to use tax collection obligations is still liable for use tax on the |

[18] A bandwidth tax is defined as "any transactional tax imposed on or measured by the physical capacity of an available signal to transmit information electronically or by fiber optics."

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| | | Internet access provider who doesn't offer screening software to limit access to material that is harmful to minors.<br><br>The ITFA preserves state and local taxing authority to the extent the particular tax is not covered under the moratorium.<br><br>Legislation enacted along with the ITFA includes sense-of-congress declaration that the Internet should be free of foreign tariffs, trade barriers, and other restrictions. This declaration sets out the negotiating objectives for the U.S., which includes accelerating growth of e-commerce by expanding market access opportunities for the exchange of goods, services, and digitized information. There is also a sense-of-Congress declaration that no new federal taxes should be imposed during the moratorium.<br><br>The ITFA also calls for formation of a 19-member Advisory Commission on Electronic Commerce. The members include the Commerce and Treasury secretaries, the U.S. Trade Representative, 8 people representing state and local governments (including one from a state with no sales tax and one from a state with no income tax), and 8 from e-commerce industries (including one small business representative). This group is to conduct a thorough study of all levels of tax with respect to e-commerce, including considerations of all types of remote commerce. Their report is due in April 2000.<br><br>See Appendix C for more information on the ITFA. | goods. |
| October 1998 | Discussion by OECD | *OECD October 1998 Ottawa Conference—"A Borderless World - Realising the Potential for Global Electronic Commerce"*[19]<br><br>At the Electronic Commerce and Taxation conference, senior tax officials from several countries and business representatives reached a joint declaration on taxation and e-commerce. Common views included: i) governments and businesses must co-operate in implementing a taxation framework for e-commerce in order for the full potential of new technologies to be realized; ii) new technologies have a great potential to simplify tax systems and enhance taxpayer service; iii) the tax framework for e-commerce should be guided by the same principles that are used in conventional commerce; iv) "significant input is needed and invited by the OECD from other governments and private sector."<br><br>A report, "Electronic Commerce: Taxation Framework Conditions," was released by the OECD's Committee on Fiscal Affairs. The report noted taxpayer service opportunities presented by new technologies and that broad taxation principles should apply to e-commerce. With respect to consumption taxes, two conclusions of particular interest to state and local governments are,<br><br>• "Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction."<br><br>• "For the purpose of consumption taxes, the supply of digitized products should not be treated as a supply of goods." | |

[19] Documents from this conference can be found at http://www.oecd.org/daf/fa/e_com/Ottawa.htm.

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| October 1998 | Federal Regulations | *Classification of Software Revenue for Tax Purposes*<br><br>Final regulations providing guidance on the classification of revenues from transactions involving computer programs under certain international provisions of the Code were issued at §1.861-18 (T.D. 8785, 10/2/98). These rules provide guidance on when transfer of software should be classified as sale of goods rather than as royalty income from licensing of a copyright. | As suggested in the 1996 Treasury report, it may make sense to extend the approach of these regulations to transfers of other types of digitized products. |
| November 1998 | Report by a State Government Committee | *Input from Governor Wilson's Advisory Council*<br><br>The Council was created by (former) Governor Wilson to examine issues and the role of government in the areas of taxation, privacy, consumer protection, and regulation. Tax recommendations included:[20]<br><br>• The basic tax principles of neutrality, low rates with a broad base, transparency and ease of implementation should be followed.<br>• State and national governments should harmonize rules for all types of taxes.<br>• "A streamlined tax system should be devised for mail order, telemarketing, television home shopping, e-commerce retail sales of goods." States should be allowed to collect sales and use taxes from sellers, if the system is first simplified. Such a system should only apply to sales of tangible personal property.<br>• The State should monitor whether sales of electronically delivered goods has become so significant such that the physical delivered items should also be made non-taxable for sales tax purposes. | |
| January 1999 | Non-tax Internet Jurisdiction Decision | *Non-Tax Jurisdiction (nexus) Cases*<br><br>*Millennium Enterprises v. Millennium Music*, 33 F. Supp. 2d 907 (DC Or 1999), involved a situation that likely will be repeated where what used to be main street businesses expand into e-commerce and discover that their name is similar (or identical) to the name of a business located in another state. Music Millennium (P), a retail music operation located in Oregon since 1969 brought a trademark infringement action against Millennium Music (D), a retail music operation in South Carolina. Both businesses had expanded to the Web. For D, Internet sales represented a tiny fraction of its total sales and the only purchase by an Oregon resident was one made at the request of a friend of P's attorney to help establish jurisdiction in Oregon. One month after the suit was filed, D added a disclaimer to its Web site indicating that its products and franchise circulars were not available in Oregon.<br><br>The *Millennium* case includes a fairly comprehensive discussion of personal jurisdiction based on an Internet site and a review of the key cases in this area. The court noted that unlike a newspaper or television ad, most Internet ads are not directed at specific geographic groups. A review of recent cases indicated that just having a Web site was not enough to find jurisdiction, but that "something more" was required to show that D purposefully directed its activities to the forum (*Cybersell, Inc. v. Cybersell, Inc.*, 130 F.3d 414 (9th Cir. 1997)). However, the court noted that cases had not been consistently decided, particularly with respect to situations where the defendant's activities fell in between the spectrum of a passive Web site which only | Tax nexus—While the *Quill* case has already held that efforts to sell in a state (such as by mailing catalogs to residents) satisfies the due process requirement for jurisdiction, this may not be enough for all types of e-commerce businesses. For example, if a web site is selling regionalized merchandise (such as something related to a college or sports team in the area), yet anyone could order a product, has the business purposefully directed its activities to residents of the state? How many sales outside of the region would be necessary for a state not located in the region to make the business comply with state tax laws? Or is setting up a web site that does not prohibit customers in any particular state constitute directing activities to Internet users in all states?<br><br>*Relevance:* While Congress can enact a law to "get around" Commerce Clause concerns, it cannot do so with respect to Due Process Clause concerns (refer back |

[20] Report available at http://www.e-commerce.ca.gov.

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| | | provides information and a situation where the defendant is conducting business with residents of the forum state. The situations involving an interactive site which allows users to exchange information with the host computer fall in between and thus requires "further inquiry into the 'level of interactivity and commercial nature of the exchange of information' to determine whether jurisdiction should be exercised" (quoting *Zippo*, 952 F. Supp 1119, 1124 (WD Pa 1997). The court found that D made no deliberate and repeated contact with Oregon. It also noted that D's Web site directs people to visit the physical store and was unlikely directed at people on the other side of the country.<br><br>The court also discussed the problem of asserting jurisdiction based on very limited contact or just the potential for contact, noting that a foreign defendant could be hauled into court in any state and did not believe that personal jurisdiction was intended to reach so widely. The court noted that "the imposition of broad territorial concepts of personal jurisdiction on the commercial uses of the Internet has dramatic implications, 'opening the Web user up to inconsistent regulations throughout fifty states, indeed, throughout the globe,'" a situation that would likely prevent small businesses from expanding into e-commerce. The court found that until D is transacting business with Oregon residents or making some other contact, it is not subject to jurisdiction there. | to the discussion of these two elements of the U.S. Constitution at the beginning of this chart). |
| January 1999 | Federal Legislative Proposal | *First Proposal to Make the Federal Moratorium Permanent*<br><br>S. 328, the Internet Consumer Protection Act, was introduced by Senator Smith. He states: "we should refuse to transform the Internet into a pot of gold for state and local tax collectors." He notes that governments have other options for raising revenue, many local governments are producing budget surpluses, Internet shoppers are already paying shipping costs when they buy goods, main street vendors are not prevented from expanding to the Internet, and new taxes on Internet-related revenues could hinder the development of -e-commerce. | Despite the implications from the comments accompanying introduction of S. 328, Senator Smith does not call for repeal of use taxes and does not address issues of neutrality between e-commerce and other types of commerce. Also, the ability of subnational governments to raise other revenues varies from state to state. In California, local governments face several obstacles to replacing an eroding sales tax base with other revenues (such as supermajority vote requirements). In addition, while the income tax is increasing in the current "boom economy," most local governments do not share in this windfall. |
| January 1999 | Activity of the OECD | *Formation of Technical Advisory Groups (TAGs)*<br><br>Following the October 1998 OECD conference in Ottawa, five TAGs were formed in the following areas: 1) technology, 2) professional data access, 3) consumption taxes, 4) business profits, ad 5) income characterization. Each TAG will function for two years and includes individuals from OECD member countries, non-OECD countries and the private sector. The TAGs are to analyze tax issues in their particular area and work towards solutions.[21] | The TAGs should serve as a vehicle for broad discussion and analysis of key e-commerce tax issues at the global level. The inclusion of non-OECD countries should help ensure that those developing countries are not left out of this important debate and development of solutions. |
| February 1999 | Proposal by State Governors | *National Governors Association (NGA) Proposal*<br><br>The NGA has called for industry and government to work together to streamline sales tax systems. Elements of this group's plan include:[22] | The NGA estimates that state and local governments lose about $3.5 billion per year from the inability to collect use tax on mail-order sales, and that the amount |

[21] For more information and current status, see http://www.oecd.org//daf/fa/e_com/tag.htm.
[22] See http://www.nga.org/Pubs/Policies/EC/ec12.asp.

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| | | • Greater consistency among states with respect to definitions, forms, rules, and audit requirements.<br>• Simplification though uniform registration, forms, remittance requirements, and filing procedures. The NGA suggests that a system of independent third-party organizations to remit taxes to the states be considered. Use of such a system by remote sellers would eliminate the need to file forms with each state.<br>• Congress should require remote sellers to collect sales tax for any state that has simplified its sales tax system per the above principles. Exceptions should be provided for remote vendors with de minimis sales. However, small companies should be required to collect under the independent third-party administration system, but there should be no charge to such companies.<br>"Although state action is needed to simplify the sales tax, federal action will be needed to ensure that it can be fairly applied." | will increase as e-commerce grows.[23] |
| February 1999 | Business Activity | *Better Data*<br>The Department of Commerce announced that it would gather data on online shopping as part of overall retail sales beginning in mid-2000. | This data will help state and local governments get a better idea of the potential sales and use tax losses from e-commerce and gauge the growth of these sales. |
| June 1999 | Activities of the AC-EC | *First Meeting*<br>The federal Advisory Commission on Electronic Commerce (ACEC) holds its first meeting in Virginia. Governor Gilmore of Virginia is selected as chair and an executive director is selected. | Due to lack of a mechanism to ensure that the Commission would have the balanced number of government and industry members, it ended up with nine industry reps and only seven from government - a problem that delayed the work of the commission, cutting into its already short existence. |
| June 1999 | Private study | *Minimal Tax Impact to State and Local Governments*<br>A study by Ernst & Young LLP concluded that 63% of business-to-consumer online sales were non-taxable (such as airline tickets, gambling, and interactive games). Of the remaining 37% of business-to-consumer sales, sales tax was paid on 4% (4% of the 100% of business-to-consumer sales), and 20% was a substitute for other remote sales for which no tax was collected, leaving 13% of total business-consumer sales untaxed. The study applied an average state and local sales tax rate of 6.5% to determine that the estimated sales tax loss was $170 million for 1998, representing one-tenth of 1% of total state and local sales tax collections.[24] | While the current revenue loss is small, the expected growth of e-commerce will create a much larger loss. However, while losses are small is probably the best time to derive a solution. However, many of these problems, such as loss of state and local tax base and competitive disadvantages for main street retailers, were identified in an extensive report on state taxation of interstate commerce completed by Congress in 1965 (the "Willis" report, discussed earlier). What has prevented these problems from being resolved in the past 35 years and can they be resolved now? Arguably, one stumbling block has been the inability of states, cities, counties and businesses to work effectively together to resolve issues, such as the complexity of the sales tax systems. |
| July 1999 | Economic Study | *Economic Analysis of Impact of Taxing E-Commerce*<br>Professor Austan Goolsbee of the University of Chicago issued an update to his original study | This data has been cited often by those who want to expand the Internet tax moratorium. However, additional factors that should be considered before |

[23] NGA, "Fair Taxation in Cyberspace," 10/2/98, http://www.nga.org/Internet/NYTimes19981002.htm.
[24] Ernst & Young, *The Sky is Not Falling: Why State and Local Revenues Were Not Significantly Impacted by The Internet in 1998*, June 18, 1999.

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| | | of November 1998—"In a World Without Borders: The Impact of Taxes on Internet Commerce." One of the findings of the report is that application of existing sales taxes to Internet transactions will lead to a 24% or more reduction in the number of on-line shoppers. In a May 1999 report, "Evaluating the Costs and Benefits of Taxing Internet Commerce" (by Goolsbee and Jonathan Zittrain), the authors conclude that for the next several years, sales tax losses will be very small, but will grow to about a 10% loss of the sales tax base by 2007.[25] | creating a sales tax moratorium for e-commerce include: a) once a temporary moratorium is in place, there will be many that will expect it to continue permanently, b) an exemption is not distributionally neutral due to the digital divide, and c) if a moratorium is designed to encourage growth of e-commerce, perhaps other options should be considered, rather than just the easiest one of not charging sales tax. |
| July 1999 | State Government Group Action | *NCSL Develops Principles for Taxation of E-Commerce*<br>The National Conference of State Legislators adopted seven principles to guide the group's lobbying efforts on improving state taxation of e-commerce. The principles are:[26]<br>1. Transactions should be treated in a competitively neutral manner.<br>2. "A simplified sales and use tax system that treats all transactions in a competitively neutral manner will strengthen and preserve the sales and use tax as vital state and local revenue sources and preserve state fiscal sovereignty."<br>3. E-commerce vendors should not be given preferential tax treatment over main street retailers and should not be burdened with any special taxes.<br>4. States should recognize that "significant simplification" of sales and use tax systems is necessary in order to reduce the administrative costs of collection.<br>5. If a simplified system is created, remote vendors should be required to collect use taxes.<br>6. "NCSL should encourage current and future cooperative efforts by states to simplify the operations and administration of sales and use taxes."<br>7. NCSL will continue to oppose federal actions to preempt states' rights to determine their own tax policies. | How will NCSL begin the process of getting states to work together to simplify their sales and use tax systems? Does simplification also mean uniformity between the states? How will NCSL also get local governments to agree to these principles?<br>If states actually did significantly simplify their tax systems, would Congress need to act to require remote vendors to collect use tax? In the *Quill* decision, the Court found that use tax collection would impede interstate commerce because of the complexity posed by over 6,000 taxing jurisdictions. Perhaps if these jurisdictions had similar and simpler systems, such a finding would no longer result. |
| July 1999 | Report from the Federal Government | *Digital Divide*<br>The Department of Commerce releases report—*Falling Through the Net: Defining the Digital Divide*, which provides information on the growing gaps between the "haves" and "have-nots" in terms of Internet usage and access. The report points out the gap between high income and low income individuals, as well as the racial divide finding that Black and Hispanic households are 2/5 as likely to have access to the Internet at home as White households.[27] | Any tax moratorium should be analyzed in terms of whom it is benefiting. As e-commerce participants tend to be middle- and high-income taxpayers, tax breaks will benefit these groups. |
| July 1999 | Federal Legislative Proposal | *Federal Level Tax?*<br>S. 1433, the Sales Tax Safety Net and Teacher Funding Act (Hollings), proposes to impose a federal 5% tax on retail sales of merchandise via the Internet or mail order. A credit would be available (not to exceed 5%) for state and local sales tax paid by the buyer on the goods. The revenue collected would go to a trust fund to assist states in compensating teachers. | Perhaps this proposal will lead to a more serious discussion of how fundamental tax reform at the federal level (such as replacing all or part of the income tax with a flat tax or national sales tax) can be coordinated with e-commerce tax issues at the state and local levels. |

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[25] See http://gsbadg.uchicago.edu/.
[26] See http://www.ncsl.org/programs/fiscal/tctelcom.htm.
[27] See http://www.ntia.doc.gov/ntiahome/digitaldivide/index.html.

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| July 1999 | Report by the United Nations | *United Nation's Human Development Report*<br><br>The United Nations issued Human Development Report 1999 which provides background to and solutions for dealing with various gaps that exist throughout the world, such as technology, wealth, and education. One solution offered for narrowing the technology gap is to create new funding mechanisms, such as a bit tax or a patent tax. These types of taxes would raise funds from people with the technology and could be used to help provide the benefits to a broader group. A press release about the report notes that a tax of 1¢ on every 100 e-mails would generate over $70 billion per year.[28] A subsequent statement from the U.N. indicates that the "bit tax" example is an illustration and it has no power to tax.<br><br>The report also notes that while OECD countries represent only 19% of the world's population, they represent 91% of Internet users.[29] | S.Con.Res. 52 (106th Congress) proposes a sense of Congress opposition to a bit tax on Internet data mentioned by the U.N. It notes that Americans would be disproportionately affected by a global Internet tax. Also see H.Con.Res. 172. |
| July 1999 | Non-tax State Jurisdiction Decision | *Virtual Presence?*<br><br>A 1999 case involved the issue of where a person is "virtually" when she surfs the Internet. For example, if servers in Antigua are used by a New York resident to engage in on-line gambling is that person gambling in New York (illegal) or in Antigua (legal)? In July 1999, a New York State Supreme Court judge ruled that the person is gambling in New York and the gaming company is, in effect, enabling the resident to gamble in a virtual casino in New York, which is illegal. The judge upheld the New York Attorney General's action to freeze $800,000 in assets of the gaming company. While the Attorney General was unable to gamble when entering New York at the gaming site, it was allowed when he typed in Nevada.[30] | On-line gambling challenges long-established theories of law and society. Governments regulate physical casinos, and expect to do the same on the Internet despite the difficulties of doing so. For example, how much verification should an on-line gaming provider seek to try to stay outside of states where gambling is illegal? A similar issue will exist when digitized products are provided over the Internet and governments expect the vendor to determine the state where sales tax should be collected (should the law ever be changed to overrule *Quill*). Also, should concepts of "presence" be revised on the Internet? Should we also assume that a vendor is present in a customer's computer, with such virtual presence sufficient to create tax obligations? |
| July 1999 | Industry Study | *Internet Clusters*<br><br>A report issued by Joint Venture: Silicon Valley Network analyzes the how and why of Internet company location decisions. One finding of the study is that the most cited reason for a particular location choice is availability of employee talent (75%), location of the company founder (63%), proximity to core (non-Internet) businesses (52%), established infrastructure (45%), proximity to customers (37%), access to venture capital (26%), and closeness of educational and research institutions (25%).[31] | Would Internet companies be likely to locate or relocate in a tax haven? |
| August 1999 | Business Activity | *Some Main Street Retailers Take Action*<br><br>The American Booksellers Association sent letters to state governors and sent a "Sales Tax Action Kit" to ABA members. The letters suggest that Amazon.com has nexus in states where it has "associates" participating in its Associates Program, and that barnesandnoble.com and | Will any governor or state tax agency assess use tax liability upon Amazon.com? Does the associates program create an agency relationship such that the company has a physical presence in the state?[33] |

[28] United Nations, *Human Development Report 1999*, page 108, and http://www.undp.org/hdro/E3.html.
[29] United Nations, *Human Development Report 1999*, July 1999, http://www.undp.org/hdro/99.htm.
[30] Anthony Ramirez, "Judge Rules Internet Gambling Is Not Beyond Reach of State Authorities," *New York Times Cybertimes*, 7/27/99; World Interactive Gaming Corporation. Also see http://www.oag.state.ny.us/press/1999/jul/jul26a_99.html.
[31] *Joint Venture's Internet Cluster Analysis*, July 1999; http://www.jointventure.org.

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| | | Borders.com have such close connections to their parent corporations to have the same nexus (rather than only having nexus where the few physical locations of the internet companies are located).[32] | |
| September 1999 | Report of a Business/ Government Group | *National Tax Association (NTA) Communications and Electronic Commerce Tax Project*[34]<br>This industry-government group was formed in late 1996 to address state and local tax issues of applying subnational taxes to e-commerce, and to reach consensus, possibly in the form of model legislation for states to adopt. The group consists of 16 people from industry, 16 from government and 7 "other" from universities, the ABA, and the AICPA.<br><br>The federal Internet Tax Freedom Act provides that the Advisory Commission shall "to the extent possible, ensure that its work does not undermine the efforts" of the NTA E-Commerce group.<br><br>Final Report: In September 1999, the NTA group issued its final report. This report includes a very important caveat that "Nothing is agreed to until everything is agreed to." Thus, none of the preliminary conclusions noted in the report are to be considered final conclusions. Some of the significant preliminary recommendations or resolutions adopted, subject to the caveat, are,<br>• There should be one rate per state with some type of measure taken to "ensure protection and equitable distribution of revenues to local jurisdictions."<br>• States should have the ability to set their own tax base (no uniform base should be prescribed for the states).<br>• Transactions should only be sourced to the state level, not to the local level. Sourcing should be on the destination basis. If sourcing information is not available, default rules, to be developed, should be followed.<br>• State and local sales and use tax administrative rules should be simplified. Possible approaches include better use of technology, creating uniform vendor registration and exemption forms.<br><br>The NTA group could not issue any resolution regarding telecommunication taxes because it could not agree on a definition of "telecommunications." | After almost three years of activity, this government-industry group was unable to reach a consensus on the difficult issues of applying sales and use taxes to e-commerce. Will the ACEC be any more successful? What is the next step? |

[32] See http://www.bookweb.org/news/pressroom/2304.html.
[33] See "nexus" discussion in Professor Nellen's e-commerce taxation outline (http://www.cob.sjsu.edu/facstaff/nellen_a/e-links.html) for the legal background on this topic.
[34] Draft papers and background information on the project are available on the Internet at http://www.taxadmin.org/nta/ and http://www.nhdd.com/nta/ntaintro.htm.

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| September 1999 | Federal Legislative Proposal | *Another Presidential Candidate Calls for a Permanent and Expanded Moratorium*<br><br>Senator McCain introduced S. 1611 which would (a) make the moratorium permanent, (b) expand the coverage of the moratorium to also include sales and use taxes for domestic or foreign goods or services acquired through e-commerce, and (c) resolve that the U.S. representatives to the WTO and similar organizations advocate that e-commerce not be burdened by national or local regulations, taxation or imposition of tariffs. Senator McCain advocates that the Internet be a worldwide "tax-free zone." He invites those favoring a different approach to step forward with a good reason and approach justifying it. "I look forward to debate on what is a fair tax system in the United States, at both the national and state levels. However, while we continue that debate, we must also ensure that we do not perpetuate the problems currently ingrained in our tax system by applying them to the Internet." [Cong. Rec. 9/22/99] | Calls for a permanent moratorium do not explain why e-commerce should not be taxed or why subnational governments should not be encouraged to try to collect use tax on e-commerce retail sales, as this tax is not a new tax (although it is often referred to by politicians and reporters as a new tax). |
| September 1999 | Industry Action | *American Electronics Association (AEA) Adopts Guiding Principles of Internet Taxation*<br><br>1. E-commerce should bear no greater tax burden than other forms of commerce.<br>2. Tax administration should be simplified, such as adopting one-rate per state.<br>3. The physical presence nexus standard should be retained and clarified through expansion of P.L. 86-272.<br>4. New specific taxes on e-commerce, such as bit taxes, should be avoided.<br>5. Tax issues must be considered within the global context.[35] | How easy is it to reconcile the principles of industry with governments (see next box)?<br><br>The AEA is one of the few groups to highlight the need to consider the global context of e-commerce in resolving tax issues related to this new business model. This is important because U.S. tax systems are already out of sync with the type of consumption tax systems used throughout the world. Almost the entire world uses value-added taxes (VAT) to tax consumption, rather than a sales tax. These systems tend to tax a broader range of consumption, including services. Also, rules already exist for taxing cross-border transactions. As the global market becomes a reality for consumers, we will see more U.S. customers buy from foreign vendors. How will states collect use tax from these transactions if we don't work towards moving the state consumption taxes towards a model that better coordinates with those in other countries? |
| September 1999 | Local Government Action | *State and Local Government Organizations Adopt Four Broad Principles of Internet Taxation*<br><br>The National League of Cities (NLC) reports that seven organizations representing state and local governments adopted the following principles:[36]<br><br>1. Competitive neutrality should exist in the marketplace.<br>2. An expanded duty to collect should be implemented.<br>3. Federal preemptions over state and local tax systems should be avoided.<br>4. Tax simplification and systems modernization should occur. | |
| September 1999 | Activities of the ACEC | *Parameters for an E-Taxation Model*<br><br>At its September meeting in New York City, the Commission created a list of a list of 18 criteria for simplified application of sales tax to e-commerce. The criteria:[37]<br><br>1. How does this proposal fundamentally simplify the existing system of sales tax collection?<br>2. How does this proposal define, distinguish, and propose to tax information, digital goods, and services provided electronically over the Internet? | Prior to its December 1999 meeting, the ACEC received over 30 proposals. However, three were the focal point of the commission's December 1999 meeting. These were the proposals of Commissioners Andal, Gilmore, and Leavitt (all discussed in the timeline). |

[35] See http://www.aeanet.org/aeanet/PublicPolicy/patxet0998_ecommerceprinciplespp1of2.htm.
[36] See http://www.nlc.org/brooks.htm.
[37] The 18 criteria are taken verbatim from the AC-EC's "Invitation for Proposals" at http://www.ecommercecommission.org/invite.htm.

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| | | 3. How does this proposal protect against onerous and/or multiple audits?<br>4. Does this proposal impose any taxes on Internet access or new taxes on Internet sales?<br>5. Does this proposal leave the net tax burden on consumers unchanged?<br>6. Does the proposal impose any tax, licensing or reporting requirement, collection obligation or other obligation or fee on parties other than those with a physical presence in a particular state or political subdivision?<br>7. What features of the proposal will impact the revenue base of federal, state, and local governments?<br>8. Does this proposal remove the financial, logistical, and administrative compliance burdens of sales and use tax collections from Sellers? Does the proposal include any special provisions with respect to small, medium-sized, or start-up businesses?<br>9. Does the proposal treat purchasers of like products or services in as like a manner as possible through the implementation of a policy or system that does not discriminate on the basis of how people buy?<br>10. Does the proposal discriminate against out-of-state or remote vendors or among different categories of such vendors?<br>11. How does this proposal affect U.S. global competitiveness and the ability of U.S. businesses to compete in a global marketplace?<br>12. Can this proposal be scaled to the international level?<br>13. How does this proposal conform to international tax systems, including those that are based on source rather than destination? Is this proposal harmonized with the tax systems of America's trading partners?<br>14. Is the proposal technologically feasible utilizing widely available software to enable tax collection? If so, what are the initial costs and the costs for required updates, and how is to bear those costs?<br>15. Does the proposal protect the privacy of purchasers?<br>16. Does this proposal respect the sovereignty of states and Native Americans?<br>17. How does this proposal treat local governments' autonomy and their ability to raise a greater or lesser amount of revenues depending on the needs and desires of their citizens?<br>18. Is the proposal constitutional? | |
| September 1999 | Proposal Addressing Sales & Use Taxes | *Proposal of a Member of the ACEC*<br>Dean Andal, member of the ACEC and California Board of Equalization, calls for a uniform national standard for taxing e-commerce that requires a substantial physical presence. Mr. Andal would modify P.L. 86-272 to limit the types of activities that can create nexus and to expand the types of taxes covered. | Since the e-commerce model is one where a business needs very few physical locations to reach customers in many jurisdictions, a physical presence nexus standard decreases the number of locations where sellers would have to collect use tax. How will states be able to collect this tax from the buyers? |

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| September 1999 | Private Opinion Polls | *The Public Doesn't Want to Tax the Internet*<br><br>At least two public opinion polls were held to gauge consumer attitudes about Internet taxation. A poll conducted by @Plan found that 73% of adult Internet users were opposed to a national sales tax on goods and services sold over the Internet.[38]<br><br>A poll conducted by the Information Technology Association of America (ITAA) found that 34% of voters would be less likely to make either a mail order or Internet order if the vendors were required to collect sales tax from them.[39] | Surprise, surprise!<br><br>Most consumers have no idea what a use tax is or that they owe it when they purchase mail order or e-commerce order items for which the vendor did not charge sales tax. Also, the press tends to refer to the use tax as a "new" tax. |
| September 1999 | California Senate | *E-Commerce Report*<br><br>Some of the interesting aspects of this overview report to e-commerce and its tax issues include:[40]<br><br>• With improved technology, the State Board of Equalization (BOE) will have more sources of data on who owes tax.<br><br>• "By the middle of this decade, California residents were saving an estimated $180 million to $200 million yearly by avoiding use taxes on out-of-state mail-order purchases."<br><br>• "The BOE, in March of 1999, estimated an annual sales- and use-tax revenue loss in California of $18.5 million based on its best estimate of 1998 e-commerce." | |
| September 1999 | OECD | *OECD Permanent Establishment Proposal*<br><br>The OECD Working Party No. 1 on Tax Conventions and Related Questions issued a draft proposal on application of the permanent establishment definition (from Article 5 of the OECD Model Tax Convention) for e-commerce transactions.[41] The drafters did not propose any change to the definition of PE, because the Committee on Fiscal Affairs, to which it reports, has indicated that the existing definition is capable of being applied to e-commerce. In addition, a different working group is addressing the issue of how much income should be attributed to e-commerce operations carried on by a PE. Significant elements of the draft include:<br>a. A web site cannot be a PE because it is not tangible.<br>b. A business does not acquire a place of business merely by having its web site hosted by an ISP in a particular location because the "server and its location are not at the disposal of the enterprise, even if the enterprise has been able to decide that its web site should be hosted on that particular server." In addition, since the ISP cannot conclude contracts for the customer, they are not agents of the customer.<br>c. "Automated equipment that does not require on-site human intervention for its operation may still constitute a permanent establishment."<br>d. A server is only fixed if it is located at a particular place for a "sufficient period of time." | While a computer server is a physical asset that must be present somewhere, it is different than other types of stand-alone, automated business equipment, such as a vending machine, that can create a PE. A vending machine is purposefully placed in a particular location in order to serve customers at that location. On the other hand, a server can be located anywhere and can serve customers located anywhere in the world who are able to connect to the Internet. Also, as Internet technology continues to evolve, servers (or their equivalent) might be located on satellites, rather than at a physical location on Earth. Arguably, certainty and a better determination of where business profits should be taxed would be provided by stating that a server alone cannot constitute a PE.<br><br>Providing that a server alone cannot create a PE would also make more sense from an economic perspective because the operations associated with a server are minimal. Instead, business operations are still comprised of the headquarters and manufacturing and sales operations that host personnel who are the real engines |

38 See http://www.corporate-ir.net/ireye/.
39 See http://www.itaa.org/news/pr/pr19990914a.htm.
40 "Taxing Internet Sales and Access," Publication #99-1, Sept. 1999, http://www.sen.ca.gov/sor/e-commerce.html.
41 1999 WTD 189-16.

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| | | In March 2000, a revised PE draft was issued by Working Party (discussed later). | of revenue generation.<br><br>*Relationship to U.S. nexus standards:* Can a nexus standard at the state and local level tie to a PE rule as a step towards harmonizing definitions in our global economy? Is such an approach feasible, or is the fact that two different taxes are being compared and the constraints provided by the U.S. constitutional mean that PE should not be equated to a U.S. nexus standard for sales and use taxes? |
| September 1999 | Federal Legislative Proposal | *International Internet Taxation Moratorium*<br><br>Congressman Cox and Wyden of ITFA fame introduced H. Con. Res. 190 in September 1999 (S. Con. Res. 58 in the Senate). This resolution urges the President to "seek a global consensus supporting (A) a permanent international ban on tariffs on electronic commerce; and (B) an international ban on bit, multiple, and discriminatory taxation of electronic commerce and the Internet." In addition, the resolution urges the President to oppose any proposal by the United Nations or any country for a bit tax on electronic transmissions. Finally, the resolution urges the President to seek to make permanent and binding the current moratorium on tariffs on electronic transmissions that was adopted by the World Trade Organization (WTO) in May 1998.<br><br>H.Con. Res. 190 was passed by the House on October 26, 1999 (423-1) and was agreed to by the Senate on November 19, 1999. | |
| October 1999 | IRS Activities | *IRS Compliance Study*<br><br>The IRS Buffalo District identified 18,000 commercial web sites to study, selecting 429 for audit. One of the preliminary findings is that for about 10% of these sites, the beneficial owner could not be identified. The IRS also found that about 65% of the companies audited expensed the costs to develop their web site, which the IRS believes should have been capitalized and amortized. The IRS also found that some taxpayers are buying expensive fishing equipment from outside of the U.S. and avoiding excise taxes, with the problem due to the "disappearing middleman." Finally, the IRS found that some ISPs did not file tax returns.[42] | Will the Service issue any official guidance on the treatment of web development and maintenance costs? |
| November 1999 | Proposal Addressing Sales & Use Taxes | *Another Proposal of an ACEC Member*<br><br>Governor Gilmore (Virginia), chair of the ACEC, proposes to ban all sales taxes on Internet sales and services, as well as the telephone excise tax. Lost funds would be replaced using a new 1% tax on phone service that would be distributed to state and local governments. States would be encouraged to simplify their tax rules. In addition, international sales taxes and tariffs on e-commerce would be opposed. Finally, states would be allowed to use excess federal welfare dollars to purchase computers and Internet access for poor families.[43] | How is neutrality achieved if buying something on the Internet becomes cheaper than from a bricks and mortar store? |
| November | Federal | *Another Proposal to Extend and Expand the Moratorium* | S. 1611 and H.R. 3252 are different from S. 328 because |

[42] George Guttman, "IRS Studying E-Commerce Tax Problems," 1999 TNT 206-7.
[43] John Simons, "Ban on E-Commerce Taxes Urged by Panel Chief," *Wall Street Journal*, 11/10/99, B8.

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| 1999 | Legislative Proposal | H.R. 3252 (Kasich) would make the moratorium permanent as well as expand it to also cover any sales or use tax on domestic or foreign goods or services acquired through electronic means. It also calls for a sense of Congress resolution that the President seek a global consensus for a permanent international ban on tariffs on e-commerce and on bit, multiple, and discriminatory taxation of e-commerce and the Internet. | they would expand the moratorium to also include sales and use tax on electronic sales. They also differ from Governor Gilmore's proposal (see above) in that Gilmore's proposal only exempts remote business-to-consumer e-commerce from sales and use taxes, rather than all e-commerce. Thus, under S. 1611 and H.R. 3252, shopping malls could just install computers where customers could place their orders and pick up the merchandise at the store - with no sales tax owed. |
| November 1999 | Proposal Addressing Sales & Use Taxes | *Another Proposal of an ACEC Member*<br><br>Governor Leavitt (Utah), member of the ACEC, proposes to move towards collection of sales tax on all sales. His plan includes use of technology within a unified system that also involves a trusted third party (TTP), such as a credit card company. A justification for the TPP is to maintain taxpayer privacy by not having the customer have to disclose information to the government. This would level the playing field by treating the customer like one who goes into a retail store and pays cash (no personal data need be collected to tax the transaction). The National Governors Association (NGA) has endorsed this proposal. | The apparent goal of this proposal is to make it so attractive to use the TTP approach, that vendors who presently do not collect tax in all states will adopt it and use tax will then get collected. However, due to price competition faced by many Internet vendors and the ease of operating an Internet business with few physical locations, these presumptions are questionable. |
| November 1999 | Business Activity | *Bricks and Mortar Operation Take a Stand Against E-Commerce*<br><br>An Associated Press news item reported that the Saint Louis Galleria notified the tenants in the mall that they could not in any way promote purchasing merchandise over the Internet. Apparently, the concern is over loss of revenues to the shopping mall when people make their purchase from home or work, rather than in person at the mall.[44] The Galleria later removed its prohibition against web site promotions. | |
| December 1999 | State Activity | *Two States Alert Individuals to Use Tax Obligations*<br><br>Both Michigan and North Carolina began a process of educating taxpayers about the use tax and added lines to the personal income tax forms to collect it (Connecticut, Idaho, Indiana, Kentucky, Maine, and Wisconsin have been doing this for years). The state of Michigan has information on its web page[45] explaining the use tax, that it has been around since the 1930s, | (1) What's likely to be the compliance level? (2) Will the "burden" of keeping receipts cause individuals to encourage vendors to collect the tax instead? (3) Will other states follow the current lead of these states? (4) Consider other options (see footnote).[46] |

[44] Jim Salter, "Mall Takes Steps Against E-Commerce," The Wire, http://wire.ap.org/APnews/center_story.html.

[45] See http://www.treas.state.mi.us/mitax/suw/useindex.htm.

[46] Additional options: (a) Maine approach—The Maine Individual Income Tax form includes a line for use tax. Per the instructions, if individuals do not know the exact amount of use tax they owe, they may either multiply their Maine adjusted gross income by .04% or use a table included in the instructions (which is based on the .04% figure). If a person owes use tax on items costing $1,000 or more, he must add the tax on those items to the table amount. The instructions also note that the use tax may be reviewed and if more use tax is owed, an assessment of interest and penalty may apply. If a person does not owe use tax, she must enter zero on the appropriate line. If a person leaves the line blank, the appropriate amount of use tax will be added to his tax liability. (b) States could create policies whereby they don't buy from companies that don't collect use tax, in an effort to encourage them to voluntarily collect the tax. (c) Connecticut approach—In 1998, Connecticut passed Public Act 98-244 which authorizes the state's tax commissioner to enter into agreements with other states to collect use taxes on remote transactions. States that participate will receive up to 50% of the use tax collected.[46] (d) Compensate vendors—The cost of sales and use tax compliance for multistate vendors is high. Few states provide compensation to vendors to help offset the costs they incur in collecting the state's revenue. (e) Use of technology—For Internet purchases, e-tailers could be encouraged to include a link on the order page for consumers to indicate which state they live in. Clicking the state button would cause the consumer's credit card or whatever payment tool they are using for the purchase to also be charged for the use tax. Of course, this method might also lead people to prefer mail order over Web order and create difficulties for consumers and vendors in knowing which items in which states were subject to sales and use taxes. (f) Restore a federal deduction—The itemized deduction for state sales and use taxes was eliminated by the Tax Reform Act of 1986. Perhaps consumer reaction to paying the use tax would be less adverse if the tax were deductible on their federal income tax return (however, only about 32% of individuals itemized their deductions). (g) Convert the subnational tax into a federal tax with revenues to be returned to the state—This option would only apply to remote sales (e-commerce and mail order).

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| | | and that it benefits schools, local and state services, and Michigan retailers. The site also lists companies that collect Michigan tax and states that if consumers order from them, their "responsibility it met." It also lists companies (both mail order and Internet ones) that do not collect Michigan tax with the caveat: "If you order from these companies you need to file and pay tax. Save your receipts!" | There are some interesting advantages and disadvantages of the self-assessment approach.[47] |
| December 1999 | International Activity | The World Trade Organization's (WTO) Third Ministerial Conference meets in Seattle, Washington.[48] | |
| December 1999 | ACEC | Third meeting held in San Francisco on December 14 and 15, 1999.<br><br>Prior to this meeting, the ACEC sought proposals addressing sales tax issues and received over 30 such proposals (see September 1999 entry). Some were discussed at the December meeting, with three proposals getting the most attention (from Commissioners Andal, Gilmore, and Leavitt - see summary in this timeline). | |
| February 2000 | Federal Legislative Proposal | *Cox and Wyden Propose to Make the Moratorium Permanent*<br><br>S. 2028 and H.R. 3709, the Internet Nondiscrimination Act, propose to amend P.L. 105-277 which created the ITFA to remove the expiration date. Senator Smith also introduced S. 2036 which is similar to S. 2028. | The ITFA moratorium does not do much other than prevent state and local governments from applying taxes to Internet access. Thus, making the moratorium permanent will likely cause no appreciable harm to state and local governments (since most were not taxing Internet access prior to the ITFA). |
| March 2000 | Federal Legislative Proposal | *Senator McCain Introduces Another Internet Tax Bill*<br><br>S. 2255 would extend the ITFA moratorium in its current form through December 31, 2006. | S. 2255 is a major change from S. 1611 in that S. 1611 not only extended the moratorium, but made it permanent and expanded it to cover sales and use tax on all transactions completed via e-commerce. |
| March 2000 | ACEC | Final meeting of the ACEC was held in Dallas on March 20 and 21, 2000. They were unable to obtain a 2/3 majority vote for any particular recommendation although the Business Caucus proposal did receive 11 votes in favor. | |
| March 2000 | OECD | *OECD Permanent Establishment Revised Proposal* | |
| March 2000 | OECD | *TAG Issues Report on Revenue Characterization* | |

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[47] Advantages of the self-assessment approach: a) The use tax is already part of the law, it just doesn't have an effective collection system in most states, but most states have not made an effort to either collect it from consumers or to educate consumers as to the existence of the tax. b) Self-assessment on a state income tax form would enable states to collect use tax on purchases made from non-U.S. vendors. c) The administrative costs would be low and compliance costs would also be low, particularly if the Maine approach were used because consumers would only need to keep track of receipts for purchases over a certain dollar amount (unless they wanted to show that their purchases were less than the .04% amount). d) It may force states to simplify their laws so consumers can better determine which purchases are taxable and which are exempt. e) State and local revenues would increase without the need for Congress to overturn *Quill* (and consumers may pressure out-of-state vendors to collect the use tax for them).

Disadvantages of the self-assessment approach: a) Seven states do not have an income tax[47] and would need a separate form to collect the use tax from consumers. b) If states do not also audit the amounts reported, compliance may lessen. c) Public outcry may result from their new awareness of the use tax and lead to calls for repeal of the tax. Many years ago in California the SBE began to notify Californians returning from out of the country that they owed use tax on their purchase of tangible goods outside of the country that they brought home with them. Public outcry led to an exemption for items costing under $400. d) It would require additional recordkeeping by consumers. If the Maine approach were used, it might force consumers to pay the stated percentage amount because it might be difficult for individuals to prove that their use tax liability is actually lower. e) Consumers may have difficulty determining which purchases are taxable and which are exempt.

[48] Information on the WTO conference can be found at http://www.usia.gov/wto/homepage.htm.

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| April 2000 | ACEC | Final report submitted to Congress. The ACEC failed to reach the necessary 2/3 majority vote on any tax proposals. However, the report does include the proposals that received a simple majority vote, noting that they are not "recommendations." The report does not include proposals of the minority. The report can be obtained at the ACEC web site at http://www.ecommercecommission.org/. | |
| June 2000 | European Union | EU issued a proposed amendment to its Sixth Directive on VAT.[49] The amendment provides a mechanism to reduce the discriminatory result that presently occurs when VAT is applied inconsistently by vendors of digital goods and services. The proposal has been viewed as controversial in the U.S. because it requires non-EU businesses with annual EU sales of at least 100,000 EURO to private consumers to register in at least one EU country and collect VAT from non-business customers who purchase digitized goods and services.<br><br>The EU did not wait for action on this issue by the OECD because they believe they are following the principles set forth in the 1998 Ottawa conference. That is, the EU believes it has considered (1) consumption taxes should tax in the jurisdiction where the consumption takes place, and (2) sale of digitized products should not be treated as a supply of goods.<br><br>The proposal applies to the specified services supplied electronically, including software. For sales by a non-EU vendor to an EU business, VAT does not need to be collected because the customer is required to self-assess the VAT (reverse charge mechanism). For sales by non-EU vendors to private EU customers, the vendor must be registered in one EU member country and follow the VAT rules of that country. | Issues/Queries:<br>▪ Is the proposal enforceable with respect to non-EU companies?<br>▪ How is the 100,000 EURO de minimis rule measured – by just considering sales of digitized items to private consumers? Sales to all consumers? All sales?<br>▪ Since digitized products are involved, how will vendors know the location of the customer?<br>▪ Under the proposal, while almost all digitized items will be taxed (except for items supplied by exempt vendors), the tax rate applied to purchases by private consumers will vary depending on where the non-EU vendor registers. This can lead to continued distortion.<br>▪ Why not wait for the OECD member countries to agree on an approach to collection of tax from foreign vendors? |
| October 2001 | Federal Legislation Expires | Three-year Internet taxation moratorium expires. | |

[49] Text available at http://europa.eu.int/comm/taxation_customs/proposals/taxation/tax_prop.htm.

# Appendix A

## Traits of the E-Commerce Business Model and the Tax and Fiscal Issues They Raise

The chart below summarizes some of the tax issues facing businesses, as well as tax and fiscal issues for state and local governments posed by the e-commerce business model.

| E-Commerce Traits | Tax & Fiscal Considerations for Businesses | Tax & Fiscal Considerations for Government | *Examples* |
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| Location:<br>▪ Ability to interact with customers is not dependent on location.<br>▪ Can reach customers in many different states and countries without the need for many physical locations.<br>▪ Some physical assets needed to conduct business (such as servers) are not necessarily tied to a single physical location, but can easily be relocated without any interruption to business.<br>▪ Mobile equipment (servers through which web pages are accessed and orders processed) can easily be moved to a more favorable tax location.<br>▪ More custom inventories so less storage needs. | ▪ Reduced operating costs.<br>▪ Fewer physical facilities needed, so companies have a physical presence in very few states and countries in which they have customers.<br>▪ Sales tax issue of distinguishing between taxable goods and non-taxable services.<br>▪ Improved tax-planning opportunities due to lower costs of moving servers rather than physical structures. | ▪ Land-use decisions.<br>▪ Increased competition among local jurisdictions as they work to encourage e-commerce companies to locate their physical facility in their jurisdiction.<br>▪ Onerous tax systems can more easily be avoided by businesses. Competition among taxing jurisdictions may increase.<br>▪ Greater likelihood that residents purchase from foreign (out-of-state) vendors—use tax collection issue; dealing with a global economy.<br>▪ May need to reconsider tax rules that base jurisdiction to tax on location. A server is not like a vending machine because the server's location is not tied to the ability to serve particular customers. Also, servers can be moved. | ▪ Amazon.com (8 physical locations in U.S. and at least 3 in Europe, but customers in over 150 countries)<br>▪ Egghead.com (sells software only via the Internet)<br>▪ Purchase of cars via the Internet<br>▪ Musicmaker.com (custom CDs) |
| Transaction details:<br>▪ Possibility of anonymous transactions where products are delivered electronically and payment is made with electronic money. | ▪ Streamlined operations that in many cases can be completed by a computer that can be located anywhere in the world. | ▪ Difficulty of verifying that a transaction occurred and where it occurred; loss of an audit trail. | ▪ Sale of software and other information electronically. |

| E-Commerce Traits | Tax & Fiscal Considerations for Businesses | Tax & Fiscal Considerations for Government | Examples |
|---|---|---|---|
| Nature of products:<br>▪ Digitized products, rather than physical products. | ▪ Reduced costs of storage and delivery.<br>▪ Is the digitized product subject to sales and use tax? Laws vary from state to state. | ▪ Less tangible personal property - thus, smaller sales tax base.<br>▪ Fewer physical business locations are needed, so businesses are more likely to have customers in the state, but no physical presence (nexus). At the international level, countries will find that businesses have a permanent establishment (taxing presence for income taxes) in fewer countries. | ▪ Music, books, videos, and software |
| Nature of transactions:<br>▪ Increased use of bartering (such as for advertising on web pages).<br>▪ Improved ability to reach a larger customer base by advertising on the Internet.<br>▪ Improved ability to match willing buyers and sellers. | ▪ Valuation of the transaction for financial and tax reporting purposes.<br>▪ Ability to reach a broad market across many states and countries without the need for a physical presence, thus reducing multistate and international tax obligations.<br>▪ Reduced costs. | ▪ Fewer intermediaries who may have previously served as a tax collection point.<br>▪ Valuation and reporting issues (bartering transactions are generally required to be reported to the government and the other party for tax purposes). | ▪ http://www.bannerexchange.com<br>▪ E-Bay and other auction sites<br>▪ http://www.usbid.com/<br>▪ http://www.tradeout.com<br>▪ http://bartertrust.com/ |
| Distribution methods:<br>▪ Reduced (or sometimes changed) need for intermediaries (disintermediation). | ▪ Reduced costs to customers.<br>▪ Possible quicker service and closer tie to customers.<br>▪ New types of intermediaries created, such as ISPs, virtual malls, and various portals. | ▪ Fewer tax collection points.<br>▪ May need to attempt to collect tax (such as some excise taxes) from consumers or use new intermediaries. | ▪ Sales of clothes from manufacturer to final consumer.<br>▪ Purchase of airline tickets directly form airline's web site.<br>▪ Consumer purchase of fishing equipment from outside of the U.S. where no excise tax is collected. |

| E-Commerce Traits | Tax & Fiscal Considerations for Businesses | Tax & Fiscal Considerations for Government | Examples |
|---|---|---|---|
| Global Marketplace:<br>▪ The Internet makes it easier and cheaper for even small businesses to sell goods and services in the global marketplace. | ▪ Some small businesses may get involved in complex international and multistate tax issues. | ▪ Tax agencies may find increased non-compliance due to lack of global tax expertise within small businesses. | ▪ Various companies exist that provide assistance to small businesses engaging in e-commerce. For example:<br>http://smallbusiness.yahoo.com/<br>http://Bigstep.com/ |
| Workforce:<br>▪ Remote workforce that may be scattered throughout a state or country, rather than working in a single work location together.[50] | ▪ Issues as to whether the presence of employees in the state creates tax obligations for sales, income and other tax purposes. | ▪ Reduced infrastructure costs as more people work closer to their homes.<br>▪ Business license taxes applied to home workers. | ▪ Customer support provided via the Internet with workers working out of their homes, rather than the company's physical location. |
| More Power to Customers:<br>▪ More information on products and prices is easily available to consumers from the Internet.<br>▪ It is easy to shop for the "best deal" without leaving your computer.<br>▪ Supplier exchanges can be formed to reduce inventory, improve availability of information and to speed up orders. | ▪ Increased price competition and need to get information to consumers in a timely manner.<br>▪ Need to identify new ways to serve customers and suppliers. | ▪ Increased competition may reduce number of companies and reduce profits.<br>▪ Opportunity to benefit from new ways of purchasing goods and services. | ▪ Business-to-business supplier exchange formed in February 2000 by General Motors, Ford, and Daimler-Chrysler.<br>▪ Web sites that help consumers find the best deal on a particular product on the Internet. |

[50] The GartnerGroup predicts that by 2003, one-third of the U.S. workforce will be working remotely at least one day per week. Jack Lessinger, author of *Penturbia*, predicts that more of the workforce will move from urban and suburban settings to telecommute from remote areas including resort areas and farms. "For Bettor or Worse, IT's Influence Over Our Daily Lives Will Only Grow," *Executive Edge*, June/July 1999, page 15.

## Appendix B—Examples of E-Commerce and the Tax Issues Raised

The operation of the Internet and e-commerce requires hardware, software, data networks, Internet access providers (usually), advertising, security (such as for transmitting credit card numbers and proving the authenticity and trustworthiness of a web site), and perhaps even e-money. Users of the Internet include businesses, non-profit organizations, schools, government agencies, and individuals. Described below are hypothetical examples of Internet transactions and some of the tax issues they raise.

Query: How does the Internet Tax Freedom Act apply to each fact pattern (see Appendix C)?

*Example 1*—Problems of identifying customer location and determining if a company has nexus[51] with a taxing jurisdiction:

Super Fax, Inc. (SFI) distributes software for faxing that is only distributed via the Internet and customers pay by credit card or with electronic money. SFI does not know and does not need to know the physical location of its customers. SFI only has physical presence in California and New Mexico. SFI purchases Internet access and server space from an ISP in Oregon. The ISP has servers located in Oregon, Illinois, New Jersey, and Germany. SFI's web order page currently asks customers if they live in New Mexico and charges sales tax to customers who answer affirmatively to this question (software transferred electronically is subject to sales and use tax in New Mexico, but not in California).

Issues: Does SFI have nexus in other states? If the law were changed to impose use tax collection responsibilities on SFI, how would it know where its customers are located? Would it be allowed to rely on answers provided by customers? Would asking a customer's address be an invasion of privacy? Does SFI have foreign tax obligations? Does use of the server cause it to have a permanent establishment (PE) in Germany? How does the existence of companies like SFI affect state and local tax bases and local land use decisions?

*Example 2*—Problems of identifying the nature of the product/service:

Photo Company (PC) provides photo-processing services for its customers. PC develops the film and then converts each negative into a computerized image and e-mails the pictures to customers. If customers want the negatives, PC will mail them to the customer (most customers do not want the negatives).

Issues: (1) Should PC be collecting sales tax from customers—is the true object tangible personal property, or an intangible or services?[52] Does neutrality dictate that sales tax should be collected because this is the equivalent of selling processed photos in tangible form? If PC and its customers were in different countries would VAT or U.S. sales taxes be owed by either PC or the customers?

(2) How does the possibility of increased sales of digitized products and information affect a state's sales and use tax base? Business transactions are likely to continue to change from the provision of taxable tangible personal property to the provision of non-taxable services and information (intangible item). Consider as another example, the following California State Board of Equalization Annotation (120.0115.325; April 19, 1996).

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[51] *Nexus* refers to a connection between an entity and a jurisdiction. It is often raised as a due process issue as to whether it would be "fair" and "reasonable" to expect the entity to be subject to the laws and courts of a particular jurisdiction. Generally, for tax purposes, nexus exists if the business has a physical presence in the state. However, state laws and court decisions differ as to how much of a physical presence is needed (for example, a physical store would be a physical presence, but a repairperson visiting the state for two days may not be).

[52] This transaction should be non-taxable unless tangible personal property (the paper print) is also delivered to the customer. See SBE Annotation 120.0663, (March 12, 1996).

"A firm collects resumes at job fairs and a variety of other sources. It creates a database of these resumes and sells access to its customers in order for them to conduct searches for potential employees. The firm charges an access fee for the database search and a subscription fee based on the quantity of resumes viewed. The firm does not sell or lease any tangible personal property to its customers in the course of providing this service. Customers use their own computers and the Internet to access the database that is maintained on computers solely within the possession and control of the firm. The firm does not provide any software to the customer.

"Under these facts, tax does not apply to the firm's subscription charge or access fee to its customers for viewing its resumes database since it is not selling or leasing any tangible personal property."

*Examples 3 to 5*—Problems of determining whether "alternative" nexus theories might apply:

*Example 3*: Gift Company (GC) has traditionally only sold its products to people who visit its single location in California City X. Realizing the potential of expanded sales by advertising on the Internet, as well as joining a "virtual mall," GC enters into an agreement with Internet Mall, Inc. which operates a virtual mall. IMI provides Internet set up to allow for product searching, ordering, secure payment systems, and advertising of the mall at a variety of Web sites. IMI is physically located in Michigan.

Issues: Is IMI an agent of GC so as to cause GC to have nexus in Michigan? Is IMI soliciting sales for GC? Does this arrangement create nexus for GC in any other states?

*Additional California Issue*: If Customer in California City Y purchases something from GC, the 1¢ local sales tax goes to City X (Sales and Use Tax Regulation 1802). (However, any special district tax will go to the location of the buyer.) What is the impact to City Y, which without the Internet, likely would have seen Customer go to a physical store in City Y to purchase the item with the 1¢ tax going to City Y? Will the impact among California cities of these types of Internet sales balance out?

How to resolve this concern: The above California "issue" serves as a good question to illustrate whether California wants to resolve issues for the long-term or the short-term. Certainly, a short-term solution would be for cities to strongly encourage the bricks and mortar retailers in their cities to add e-commerce to their business strategies as a way to bring additional sales tax revenue into the city (without much cost to the city since customers won't be driving to the physical store). This likely is a short-term solution because of competition among the cities (perhaps a city will entice e-vendors by offering them some other type of tax break), if a new business strategy emerges, this one might be out of date, and it doesn't solve the long-standing problem of ineffective allocation of revenues between state and local governments.

Perhaps the better long-term strategy would be to re-evaluate the system for allocating sales and use tax dollars between cities. Such an evaluation should look at all types of state and local tax sources, costs incurred by state and local governments in providing services, and the goals for the state in terms of promoting economic growth. Our current system is flawed because while the state wants to encourage growth of businesses and high-paying jobs, cities that must provide the infrastructure to these businesses and their employees don't have the appropriate revenue streams available to them to adequately support such an infrastructure.

*Example 4*: Bricks and Mortars Store decides to become a "clicks and mortars store" by setting up a web site and selling some of its merchandise on the site. Currently, Bricks only has one physical location (in Sunnyvale). The owner is considering whether she should advertise the company's URL inside the store, in magazine and newspaper ads, in trade journals, and other vehicles. Bricks has also been approached by an ISP to enter a relationship whereby Bricks would advertise ISP services where customers would get free Internet access, but have to see advertisements (including for Bricks) every time they logged on. Will any of these actions cause Bricks to have nexus outside of California?

*Example 5*: XYZ.com has a "Helper's Program" under which organizations may earn money through sales made at XYZ.com's site when it was linked to from the organization's web page. The relationship is started when the organization submits an application that is accepted by XYZ.com. XYZ.com provides some assistance with the linking arrangement for the organization's site. A link can be provided that leads to a letter from the president of XYZ.com stating that they are pleased to have "organization" in the XYZ.com organization and that they will ship merchandise and provide customer service for the orders. XYZ.com is solely responsible for processing all orders. The agreement spells out the terms for calculating referral fees that are paid on a quarterly basis, although fees of under $200 are deferred to a subsequent quarter. The agreement states that no agency relationship is created and that the organization does not have any authority to make or accept any offers or representations on behalf of XYZ.com.

# Appendix C—Basics of the Federal Internet Tax Freedom Act

The 3-year moratorium applies to state and local taxes on Internet access, unless such tax was generally imposed and actually enforced before October 1, 1998. It also applies to multiple or discriminatory taxes on e-commerce. Exceptions: (1) persons or entities who knowingly communicate via the Web in interstate or foreign commerce for commercial purposes, materials that is harmful to minors (with some exceptions), (2) Internet access provider who doesn't offer screening software to limit access to material that is harmful to minors.

A *multiple tax* is generally defined at §1104 of the ITFA as any tax imposed by a state or political subdivision of the state on "the same or essentially the same electronic commerce that is also subject to another tax imposed by another State or political subdivision thereof (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certification for taxes paid in other jurisdictions." Multiple tax does not includes a sales or use tax imposed by a state and one or more or its political subdivisions on the same e-commerce or a tax on persons engaged in e-commerce which also may have been subject to a sales or use tax thereon.

*Discriminatory tax* has a lengthy definition at §1104 of the ITFA. The definition uses two separate focal points for the definition, with satisfaction of either leading to a conclusion that a tax is discriminatory. The first focal point looks at the "fairness" or "neutrality" of the tax, while the second focal point labels a tax as discriminatory if applied based on an overly broad definition of nexus. More specifically, the definition of "discriminatory tax" per the ITFA language follows:

> "(A) any tax imposed by a State or political subdivision thereof on electronic commerce that-- (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period; (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means; (iv) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than the tax rate generally applied to providers of similar information services delivered through other means." OR
>
> "(B) any tax imposed by a State or political subdivision thereof, if-- (i) [except for grandfathered taxes], the sole ability to access a site on a remote seller's out-of-state computer server is considered a factor in determining a remote seller's tax collection obligation; or (ii) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations solely as a result of-- (I) the display of a remote seller's information or content on the out-of-state computer server of a provider of Internet access service or online services; or (II) the processing of orders through the out-of-state computer server of a provider of Internet access service or online services."

The ITFA also establishes an Advisory Commission on E-Commerce (see charge on next page). A report, which may also contain legislative recommendations, is due to Congress in April 2000. "Any recommendation agreed to by the Commission shall be tax and technologically neutral and apply to all forms of remote commerce. No finding or recommendation shall be included in the report unless agreed to by at least two-thirds of the members of the Commission serving at the time the finding or recommendation is made."

The members of the Commission are, in addition to representatives Commerce Secretary Daley, Treasury Secretary Summers, and U.S. Trade Representative Barshefsky:

| Industry | Government |
| --- | --- |
| C. Michael Armstrong, Chairman and CEO of AT&T | James Gilmore, Governor of Virginia |
| Grover Norquist, President of Americans for Tax Reform | Dean Andal, Vice-Chair, California State Board of Equalization |
| Richard Parsons, President of Time Warner | Paul Clinton Harris, Sr., Virginia Delegate |
| Robert Pittman, President and COO of AOL | Ron Kirk, Mayor of Dallas |
| David Pottruck, President & Co-CEO of Charles Schwab | Michael Leavitt, Governor of Utah |
| John Sidgmore, Vice-Chairman of MCI WorldCom | Eugene Lebrun, Partner in Lynn, Jackson, Shultz & Lebrun, P.C., and President of the National Conference of Commissioners on Uniform State Laws (NCCUSL) |
| Stanley Sokul, Independent Counsel for the Association for Interactive Media | Gary Locke, Governor of Washington |
| Ted Waitt, Chairman and CEO of Gateway 2000 | Delna Jones, County Commissioner—Oregon |

The duties of the Commission are quite broad as explained in the following excerpt from the ITFA.

(g) Duties of the Commission—

(1) In general.--The Commission shall conduct a thorough study of Federal, State and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities.

(2) Issues to be studied.--The Commission may include in the study under subsection (a)--

(A) an examination of--

(i) barriers imposed in foreign markets on United States providers of property, goods, services, or information engaged in electronic commerce and on United States providers of telecommunications services; and

(ii) how the imposition of such barriers will affect United States consumers, the competitiveness of United States citizens providing property, goods, services, or information in foreign markets, and the growth and maturing of the Internet;

(B) an examination of the collection and administration of consumption taxes on electronic commerce in other countries and the United States, and the impact of such collection on the global economy, including an examination of the relationship between the collection and administration of such taxes when the transaction uses the Internet and when it does not;

(C) an examination of the impact of the Internet and Internet access (particularly voice transmission) on the revenue base for taxes imposed under section 4251 of the Internal Revenue Code of 1986;

(D) an examination of model State legislation that--

(i) would provide uniform definitions of categories of property, goods, service, or information subject to or exempt from sales and use taxes; and

(ii) would ensure that Internet access services, online services, and communications and transactions using the Internet, Internet access service, or online services would be treated in a tax and technologically neutral manner relative to other forms of remote sales;

(E) an examination of the effects of taxation, including the absence of taxation, on all interstate sales transactions, including transactions using the Internet, on retail businesses and on State and local governments, which examination may include a review of the efforts of State and local governments to collect sales and use taxes owed on in-State purchases from out-of-State sellers; and

(F) the examination of ways to simplify Federal and State and local taxes imposed on the provision of telecommunications services.

(3) Effect on the communications act of 1934.--Nothing in this section shall include an examination of any fees or charges imposed by the Federal Communications Commission or States related to--

(A) obligations under the Communications Act of 1934 (47 U.S.C. 151 et seq.); or

(B) the implementation of the Telecommunications Act of 1996 (or of amendments made by that Act).

The ACEC met four times and issued a report to Congress in April 2000. The ACEC failed to reach the necessary 2/3 majority vote on any tax proposals. However, the report does include the proposals that received a simple majority vote, noting that they are not "recommendations." The report does not include proposals of the minority. The report can be obtained at the ACEC web site at http://www.ecommercecommission.org/.