

For several years the political debate over "Internet taxes" has blurred important distinctions between fundamentally different taxes and tax policies. In upcoming debates, Congress must distinguish between the following taxes and decide each on its own merits:

- (1) **Taxes on Internet Access** – A tax on Internet access is a tax a consumer must pay just to log on the Internet. It's a toll required to enter the information superhighway. By 1998, dozens of local and state governments had begun to charge their citizens a tax on their monthly subscription fees to Internet Service Providers (ISPs). In many jurisdictions these taxes ran as high as 15-20%. Since most consumers already paid heavy taxes on the telephone lines used to dial up the Internet, these taxes on Internet access amounted to double taxation. In response to the growing number of state and local taxes on Internet access, Congress enacted and President Clinton signed the Internet Tax Freedom Act of 1998 which imposed a 3-year moratorium against state and local taxes on Internet access. In 2001, Congress extended the moratorium for two additional years, until November 2003, and President Bush signed the extension into law. Three bills currently pending in Congress would extend the moratorium against state and local taxes on Internet access permanently: H.R. 49 (Cox), S. 52 (Wyden), S. 150 (Allen). These bills do not address the separate issues of sales taxes or business activity taxes, outlined below. The justifications for a permanent and national moratorium against taxes on Internet access are numerous:
  - A permanent moratorium has consensus support, including state and local government lobbies.
  - Prevents a tax increase on consumers of \$30-\$100 per year to log on the Internet.
  - Prohibits double taxation of Internet access service *and* the telephone service used to dial up an ISP.
  - Promotes digital opportunities by preventing a cost increase for the 50% of Americans not logged on.
  - Protects consumer privacy because ISPs will not need to track and report each customer's location.
  - Relieves ISPs of the costs inherent in compliance with thousands of disparate tax regulations.
  - Allows small, independent and rural ISPs to compete in more markets by reducing barriers to entry.
  - Promotes Internet innovation and technology upgrades.
  - Stimulates the economy by encouraging Internet investment and preventing a tax increase.
  - Promotes U.S. global competitiveness in the digital content and services market.
- (2) **Sales Taxes on Goods & Products Sold On The Internet** – Wholly distinct from a tax on access, a sales tax is a consumption tax state and local governments impose on a consumer when he purchases a tangible product. The burden of collecting the tax and remitting it to tax authorities falls to the retailer. Under the Supreme Court's decision in *Quill v. North Dakota*, a state or local government cannot force an out-of-state retailer with no "physical presence" in the state to assume the burdens of collecting a sales tax on its sale of a product to a consumer who lives in that state or locality. To do so, the Supreme Court held, would impose undue burdens on interstate commerce. Some state/local government lobbies are asking Congress to overturn the Supreme Court's *Quill* decision legislatively and to permit them to require out-of-state catalogue and Internet-based retailers to collect, and consumers to pay, sales taxes on all interstate transactions. No bill has been introduced to overturn *Quill* as of May 2003, though there is talk one might be offered in the Summer. This sales tax issue is separate and distinct from the topic of taxes on Internet access discussed above and has engendered more controversy.
- (3) **Taxes on Business Activity** – State and local governments impose various taxes on businesses on the theory that they engage in some form of business activity within their jurisdictions. Examples of business activity taxes are income taxes, franchise taxes, gross receipts taxes, and professional license fees or taxes. Historically, states have imposed these taxes only upon businesses with a "physical presence" in their states in accordance with P.L. 86-272, enacted by Congress in 1959 to protect multi-state businesses from unfair or double state taxation. More recently, however, some state tax administrators have indicated they intend to abandon "physical presence" standards and instead impose business activity taxes on companies that have merely an "economic presence" in their states, even if the companies have no facilities or employees there. In some cases, state tax administrators have attempted to tax a company because its website was hosted on a third-party's computer in that state or because its intellectual property passed through a state. This broad expansion of state and local tax authority exposes American businesses to unclear tax rules, taxation without representation, and multiple taxes on the same business. Because the "physical presence" test is also an underpinning for sales tax collection responsibilities by retailers, legislation addressing business activity taxes and sales tax collections are often linked.