

PERMANENT INTERNET TAX FREEDOM ACT

—————
JULY 3, 2014.—Committed to the Committee of the Whole House on the State of
the Union and ordered to be printed
—————

Mr. GOODLATTE, from the Committee on the Judiciary,
submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 3086]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 3086) to permanently extend the Internet Tax Freedom Act, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

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Purpose and Summary

In 1998, Congress temporarily banned state and local governments from taxing Internet access or placing multiple or discriminatory taxes on Internet commerce. With minor modifications, this ban was extended three times, with enormous bipartisan support. The most recent extension passed in 2007, but it expires on November 1, 2014. The Permanent Internet Tax Freedom Act (PITFA) would convert the moratorium into a permanent ban—on which consumers, innovators and investors can permanently rely—by simply striking the 2014 end date.

Background and Need for the Legislation

I. HISTORICAL BACKGROUND

The Internet Tax Freedom Act (ITFA) was enacted on October 21, 1998 as Title XI of Division C of the Omnibus Consolidated and Emergency Supplemental Appropriations Act.¹ ITFA placed a 3-year moratorium on the ability of State and local governments to: (1) impose new taxes on Internet access, or (2) impose any multiple or discriminatory taxes on electronic commerce. The Act also grandfathered certain State and local access taxes that were “generally imposed and actually enforced prior to October 1, 1998.”

This initial Internet tax moratorium expired on October 21, 2001. The Internet Tax Nondiscrimination Act was then enacted on November 28, 2001.² It provided for a 2-year extension of the prior moratorium, through November 1, 2003. The moratorium was then extended for an additional 4 years, through November 1, 2007, by the Internet Tax Nondiscrimination Act of 2003, enacted on December 3, 2004.³ The moratorium was extended a third time through November 1, 2014 by the Internet Tax Freedom Act Amendments Act of 2007.⁴

II. ITFA TODAY

Previous extensions made substantive changes to the ITFA moratorium to clarify it and address technological developments. PITFA does not. It merely strikes the end date of the current moratorium. That current statutory framework appears at 47 U.S.C. 151 (note) and provides as follows:

States and localities are prohibited from imposing “[t]axes on Internet access” or “[m]ultiple or discriminatory taxes on electronic commerce.”

Internet Access

Internet access means a service that “enables users to connect to the Internet to access content, information, or other services.” This includes “telecommunications to the extent such telecommunications are purchased, used or sold to provide Internet access” (*e.g.*, DSL.) Also covered are incidental services “such as a home page, electronic mail and instant messaging[,] video clips and personal

¹Internet Tax Freedom Act, Pub. L. No. 105–277, § 1101, 112 Stat. 2681–719 (1998).

²Pub. L. No. 107–75, § 2, 115 Stat. 703 (2001).

³Pub. L. No. 108–435, §§ 2–6A, 118 Stat. 2615, 2615–2618 (2004).

⁴Pub. L. No. 110–108, §§ 2–6, 121 Stat. 1024, 1024–1026 (2007); INTERNET TAX FREEDOM ACT AMENDMENTS OF 2007, H. Rep. No. 110–372.

electronic storage capacity” whether packaged with Internet access or sold separately. The definition specifically excludes “voice, audio or video programming” or other products and services . . . that utilize Internet protocol or any successor protocol and for which there is a charge.”

Multiple or Discriminatory Taxes

A multiple tax means “any tax that is imposed by one State . . . on . . . essentially the same electronic commerce” that is taxed by “another State . . . without a credit for taxes paid in other jurisdictions.” For example, a resident of Virginia downloads a movie from a company based in Seattle while waiting at the airport in Chicago. Three states could claim the right to tax it; Virginia, Washington and Illinois. The statute does not establish priority among those claims. It merely requires credits so the customer is not subject to three separate tax levies.

A discriminatory tax on Internet commerce is defined as one that is either “not generally imposed” or is “not imposed at the same rate” on similar transactions “accomplished through other means.” Another form of discriminatory tax is separately classifying Internet service providers (ISPs) for purposes of applying a higher tax rate than is imposed on similar information services.

The term also includes any tax where a factor in determining a remote seller’s collection obligation is the sole ability to access a site on a seller’s remote server. Similarly covered are taxes where the ISP is deemed the seller’s agent solely because it displays information or processes orders for the seller on an out-of-state computer server.

Tax

The term tax includes taxes on Internet access, regardless of whether it is imposed on the seller or the purchaser of Internet access. However, it excludes taxes on net income, capital stock, net worth, or property value as well as similar broad based receipts taxes that four states rely on in lieu of corporate income taxes: These are Washington’s business & occupation tax, Michigan’s gross receipts tax, Ohio’s commercial activity tax and Texas’s margins tax.

Pornography Exception

The statute contains several exceptions. In particular, the taxing restrictions do not apply to commercial communications of pornography unless minors’ access to the material is restricted by requiring a credit card, age verification or other reasonable measures. In addition, Internet access providers cannot enjoy the benefit of the tax moratorium unless they offer customers screening software to limit minors’ access to pornographic material.

Bundling Rule

The statute concludes with a number of miscellaneous items, first of which is a bundling rule. Ordinarily, if a merchant bundles taxable and non-taxable items, the taxable item “taints” the non-taxable item and the entire bundled package is taxable. ITFA’s accounting rule changes this, enabling companies to sell consumers a bundled package of services that includes Internet access, while

allowing the vendor to unbundle the services in their internal books and records so that they can apply the tax just to the taxable portion. For example, consumers are offered a triple play package of voice, video and broadband. If the provider can reasonably identify the charges for Internet access (*i.e.*, broadband) from its books and records kept in the regular course of business, only the taxable services (*i.e.*, voice & video) will be subject to taxation and not the charges for broadband Internet access.

911 Access Fee, USF & Other Exceptions

The law specifies that it does not prohibit the collection of the 911 access or Universal Service Fund (USF) fees. The USF is imposed on telephone service rather than Internet access anyway, although the FCC periodically contemplates broadening the base to include data services. The law adds that nothing in ITFA should affect a “regulatory proceeding that is not related to taxation.” This is important because the moratorium contains terminology like “telecommunications service” which is common to other regulatory contexts where the definition of the same words may have evolved differently.

Finally, the statute exempts the Texas Municipal Access Line Fee (TMALF) from the moratorium. The TMALF is essentially a fee for the use of public rights of way to provide traditional telecommunications service. Providers did not consider the TMALF to be a tax on Internet access because it has always been imposed on communications lines used for traditional telecommunications services (e.g. voice).

Grandfathers

A grandfather clause in ITFA allows states and localities to continue imposing state and local taxes on Internet access that were “generally imposed and actually enforced prior to October 1, 1998.”

The history behind the grandfathers is instructive as to the way the law has evolved to keep pace with technological innovation. In 1998, most Internet services were dial-up. Users unplugged their phones, plugged the line into their computers and dialed into a portal like AOL. If anyone called, Internet access was disrupted. Since customers still primarily used their phones for voice calls, protecting Internet access from taxation meant focusing on the portal. That soon changed with Digital Subscriber Lines (DSL) which split the telephone line to provide a dedicated Internet portal as well as uninterrupted phone service and cable modem service. Protecting Internet access required protection not only of the portal, but the dedicated transmission piece as well. In addition, Internet access sold by cable providers, often described as cable modem service, was ruled to be an information service. States took different views as to how these services should be taxed. Some states argued the moratorium applied only to the portal not the transmission component (telecommunications transport) sold by telephone companies; because cable modem service was characterized as an information service, states often found the moratorium applied to the entire Internet access charge by cable providers. Furthermore, if the Internet service provider (ISP) billed the transmission piece separately, states generally took the position the charge for transmission was taxable telecommunications; if ISPs billed it as a

package the states often claimed the entire package, including the portal, was “tainted” and taxable while other states found the moratorium to be applicable to such charges.

The 2003 extension addressed the problem by clarifying that “Internet Access” includes the transmission (telecommunications transport or backbone] piece: “The term ‘Internet access’ . . . means a service that enables users to connect to the Internet . . . [and] . . . includes the purchase, use or sale of telecommunications . . . to the extent such telecommunications are purchased, used or sold . . . to provide such service.” As a concession, it gave states that had been taxing DSL as telecommunications until November 1, 2005 to cease and desist.

A number of states complied, but some recalcitrant jurisdictions sought to evade the law by reinterpreting the intent of the grandfathers. They claimed their taxation of the transmission component (DSL) was based upon laws “generally imposed and actually enforced” prior to 1998. This argument was strained since prior to 1998 DSL did not generally exist, however some states insisted their pre-1998 laws were always intended to apply to telecommunications services so the telecom transport component used in delivering Internet access should be covered by the original grandfather rather than the 2003 grandfather that expired in 2005.

To ensure that the transmission element (often referred to as the “Internet backbone”) remained tax free, Congress addressed this lingering transmission issue in the 2007 extension. It reinforced its intent that the moratorium on taxing Internet access included the transmission piece and that only those states subject to the original grandfather could take advantage of it. These original state taxes, identified at the time ITFA was originally enacted, were distinguishable from the recalcitrant states who had not taken public positions indicating an intent to tax the Internet portal alone, prior to 1998. Nevertheless, it gave the final recalcitrant states until June 30, 2008 to comply, provided the tax on transmission was based on a public ruling or pending litigation prior to July 1, 2007.

In sum, as the moratorium stands today, only the pre-1998 grandfather clause survives. It covers seven states. They are, SD, ND, WI, NM, HI (excise tax), TX (on amounts over \$25) and OH (tax on Internet use by business).

III. MAJOR CONSIDERATIONS

A Permanent Moratorium Is Warranted

The policy reasons for renewing the moratorium have shifted over time. The original justification was to incubate a fledgling industry. It has worked: According to the Pew Research Center, 86 percent of American adults used the Internet in 2013, up from 14 percent in 1995.⁵

Today, it is precisely the ubiquity of the Internet that councils for a permanent extension. The Internet has become the primary driver of U.S. economic growth, innovation and productivity. The Internet is indispensable for finding jobs and accessing education and healthcare resources. It helps small businesses find new markets and consumers across the country and the world. For example,

⁵NAT’L ASSOC. OF COUNTIES, PROTECT COUNTY TAXING AUTHORITY: SUPPORT A SHORT-TERM EXTENSION OF THE INTERNET TAX FREEDOM ACT (ITFA) (2014).

during the 2007 renewal, the Committee heard testimony that more than 75% of the remarkable productivity growth that has increased jobs and income since 1995 was due to investment in telecommunications networks and the information technology transported across them.⁶

One should be highly skeptical of the suggestion from States and localities that Internet adoption rates are not affected by taxes. It is an economic axiom that as price rises demand falls. If the moratorium lapses, state telecommunications taxes could take effect and those rates are already inordinately high: In 2007, the average tax rate on communications services was 13.5%, more than twice the rate of 6.6% on all other goods and services. Some rates even exceed sin tax rates. For example, in Jacksonville, Florida, households pay 33.24% wireless taxes, higher than beer (19%), liquor (23%) and tobacco (28%). Moreover, these tax burdens fall heavier on low income households. They pay ten times as much in communications taxes as high income households as a share of income.⁷

In an attempt to overcome this basic economic truth, opponents of H.R. 3086 cite a 2006 Government Accountability Office (GAO) study. They say it found “no significant difference” in broadband adoption between states that tax Internet access (pursuant to grandfathered) and those that do not.⁸ Actually, GAO said its study “indicat[ed] that the imposition of the tax may have reduced the likelihood that a household would purchase broadband service.” However, it could not be confident of that finding because it was only statistically significant at the 10 percent level, rather than the traditional 5% cutoff, and there were confounding factors.

Standing against this equivocal finding, are a number of studies showing that price has a demonstrable impact. The same year the GAO report was published, former White House Chief economist Austan Goolsbee authored a paper finding the average elasticity for broadband to be 2.75. Elasticity is a measure of price sensitivity and here indicates that a \$1.00 increase in Internet access taxes would reduce expenditures on those services by an average of \$2.75.⁹

According to a 2010 survey by the National Telecommunications and Information Administration, 24% of Americans who do not use the Internet report cost as the main reason.¹⁰ Figures from 2012 show that 25.2% of the US population remains without Internet access.¹¹ The numbers are dramatically higher for low income and minority households. Just 43 percent of households with incomes

⁶*Internet Tax Freedom Act: Internet Tax Moratorium: Hearing Before Subcomm. on Commercial and Admin. Law of the H. Comm. On the Judiciary*, 110th Cong. 30 (2007).

⁷*Id.* at 32.

⁸Michael Mazerov, *Congress Should End, Not Extend, Prohibition on Taxing Internet*, CTR. ON BUDGET AND POLICY PRIORITIES (Jun. 18, 2014), <http://www.offthechartsblog.org/congress-should-end-not-extend-prohibition-on-taxing-Internet-access/>.

⁹Adams Nager, *Misinformation in the Internet Tax Freedom Act Debate*, THE INNOVATION FILES (Jun. 23, 2014), <http://www.innovationfiles.org/misinformation-in-the-Internet-tax-freedom-act-debate/>.

¹⁰THE INFORMATION TECHNOLOGY & INNOVATION FOUNDATION, *THE WHOLE PICTURE: WHERE AMERICA’S BROADBAND NETWORKS REALLY STAND* at 35 (2013) (available at <http://www2.itif.org/2013-whole-picture-america-broadband-networks.pdf>); Presumably by “price” some respondents meant the price of hardware such as a computer, not simply the connection fee. On the other hand, hardware as a one-time cost may not present as daunting a burden as an access tax which is recurring.

¹¹U.S. CENSUS BUREAU, *COMPUTER AND INTERNET ACCESS IN THE UNITED STATES* (2012) (available at https://www.census.gov/hhes/computer/files/2012/Computer_Use_Infographic_FINAL.pdf).

less than \$25,000 had Internet access in 2011, and only 35% of households with no high school diploma. The data also showed that only 55% of African American households and 56% of Hispanic households had Internet access.¹²

These findings are consistent with the fact that, in most places in America, even an incremental cost increase is not trivial. The White House underscored this point in another context by launching an initiative called “What \$40 means to Americans Across the Country.” It highlighted how, for working families, that money “buys things like school lunches, the gas needed to get to work or visit ailing relatives, and co-pays for doctor visits and essential prescription medicines.”¹³

Finally, Internet access is not simply a consumer good to be taxed. It is the greatest gateway to knowledge and self-help that has ever existed. It is the modern equivalent of the great library of Alexandria, accessible from anywhere on the planet. Government simply should not charge citizens a fee to enter this remarkable world. Government will reap dividends later as citizens leverage unprecedented scientific, educational and economic opportunities to better their lives, improve society and grow the economy.

Action Is Needed Now

Even though PITFA enjoys enormous bipartisan support, ISPs must prepare for the possibility that ITFA could lapse. The moratorium has lapsed twice before; for a month in 2001, and 13 months in 2003. In both cases, subsequent renewals applied retroactively without much fuss. This time it would be different for several reasons:

Broader Customer Base—Consider Verizon as an example. In 2003, approximately 5% of its revenue was derived from Internet access.¹⁴ Today, it is approximately 40–45%.¹⁵ Similarly, the customer base for Internet access services has grown from approximately 6 million in 2003 to 75 million today. All these new customers mean many more Americans would be affected by new Internet access taxes.

Expiring Moratorium is Broader Today—Under early versions of the moratorium, states continued to be aggressive in taxing the data transmission associated with Internet access. States argued that Federal law only forbade taxing the Internet portal not the data transmission used to ‘travel’ the Internet. For example, they claimed the portal access to the AOL server was tax free, but the data transmission used to connect to the web and access data was not. Congress eventually closed this loophole by barring taxes on transmission to the extent it was used to provide Internet access, but not until 2004. Thus, customers were likely paying taxes on the transmission piece, which is the bulk of the charges for Internet service, even before the moratorium lapsed in 2003. Accordingly, the impact of the lapse was not as noticeable.

¹² NAT'L TELECOMM. AND INFO. ADMIN., EXPLORING THE DIGITAL NATION: AMERICA'S EMERGING ONLINE EXPERIENCE at 26 (2013) (available at http://www.ntia.doc.gov/files/ntia/publications/exploring_the_digital_nation_-_americas_emerging_online_experience.pdf).

¹³ *What 40 Means to Americans Across the Country*, WHITE HOUSE, <http://www.whitehouse.gov/40dollars>.

¹⁴ *Delivering the New World of Communication*, 2003 VERIZON COMM. INC. ANN. REP. 9.

¹⁵ *The World's Biggest Challenges Deserve Even Bigger Solutions: Powerful Answers*, 2013 VERIZON COMM. INC. ANN. REP. 2.

Today, because transmission is not taxable, consumers would be much harder hit by any lapse in the moratorium.

Expiration Could Automatically Trigger State Taxes—Montana law specifically states that should ITFA expire, Internet access will be taxed at 3.75%. In the other 49 states, it is feared that the current telecom and sales tax laws are broad enough to cover at least some portion of the Internet access under their existing statutes. In other words, were ITFA to lapse, Internet access taxes would be triggered automatically in many states without further state action. This was not a problem in 2003, because the types of taxes that would be primarily triggered by a lapse today are taxes on the transmission piece which were arguably not prohibited by ITFA at that time.

Telecommunications companies (wire-line, cable and wireless) have already begun undertaking comprehensive analyses of state and local tax statutes. It is a substantial undertaking. Their tax divisions need to examine taxation of Internet access under sales and use taxes, utility taxes, telephone taxes, wireless taxes and cable franchise fees. They need to study taxability of Internet access, broadband access, email, instant messaging, home page, video clips, personal electronic storage capacity as well as examine taxability as a telecommunications service, information service, data processing service, computer service, and digital service. The uncertainty is a drain on their resources.

Notice to Customers—If ITFA expires, broadband providers believe customers need 30–60 days' notice of the tax increase either by law, contract or as a matter of good customer service. State notice laws would primarily affect land line and cable providers because wireless carriers are not covered by most state regulatory regimes. Additionally, while customer contracts typically do not require notice of sales tax changes, many of the rate changes would be classified as telecom specific taxes which do require notice. The biggest issue is one of customer service. Consumers have not been taxed on these services for more than 10 years. One carrier estimates that the typical family could see anywhere from \$11 to \$22 in new taxes every month for using the Internet. If the tax increase is unexpected, providers anticipate a flood of calls to their customer service centers. Handling customer care calls is expensive. To prevent this, the carriers would likely begin notifying customers no later than September 1, unless PITFA becomes law sooner.

Preparing IT for Compliance—In case ITFA lapses, broadband providers are already dedicating resources to prepare their information technology and billing systems for compliance with these new taxes. In many states where taxes could be triggered, bills must list the state tax as a distinct line item on the customer's bill. More importantly, to minimize tax exposure, bundled services will have to be broken into components to separate out the portal from the transmission element. ITFA does not distinguish between these elements, but many state laws do. When ITFA expires, these states will begin taxing the data transmission, but the portal could still be tax-free under state law. If providers fail to separate out the portal piece, and tax the entire bundle, they could be at risk to class action lawsuits for collecting too much tax.

Retroactive Renewal Insufficient—Given the increased user base, ITFA cannot simply be renewed retroactively, as it was in the

past, without creating complications. States would need to work with providers to refund the taxes collected from a much larger pool of customers than existed during prior extensions. This becomes even more challenging for customers that are no longer with the provider that collected the taxes originally. Continuing customers could receive a credit on their current bill, but providing refunds to significant numbers of customers who switched to other providers would be far more challenging. For example, Verizon has customer churn of approximately 100,000 per month.¹⁶ Verizon would need to undertake a search for these customers and refund the taxes they previously paid.

Grandfathers Should be Properly Permitted to Expire

Seven states remain grandfathered under current law. They are, SD, ND, WI, NM, HI (excise tax), TX (tax on amounts over \$25) and OH (tax on Internet use by business). Both the moratorium and the grandfathers expire on November 1, 2014, but under separate expiration provisions. PITFA strikes only the moratorium's expiration provision. This allows the grandfathers to expire for the remaining seven state and local taxes, so that the tax moratorium is consistent nationwide.

There are good reasons to let the remaining grandfather lapse. For example, the original intent of the grandfather was to give states then taxing Internet access some time to transition to other sources of revenue. Indeed, a number of states discontinued their taxation of Internet access in support of a national broadband policy. For those that still haven't ceased their taxation of Internet access, it has been 16 years, time enough to change their tax codes.

PITFA enjoys support even from Members in the grandfathered states, a number of whom have signed on as cosponsors in both chambers.

Constitutional Authority

Article 1, Section 8, Clause 3 of the U. S. Constitution gives Congress authority to "regulate Commerce . . . among the several States." As the Supreme Court has explained, the Commerce Clause . . . [is] informed . . . by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills."¹⁷ The Federal ban on multiple and discriminatory taxes on e-commerce fits squarely within this authority.

Internet access taxes fall within that framework as well. Furthermore, even if the hardware to provide that connection exists entirely within the taxing state, the levy hinders access to a nationwide network. Internet access may properly be viewed as the on-ramp to the information superhighway and thus indispensable to the Internet itself. A helpful analogy may be that taxing Inter-

¹⁶*The World's Biggest Challenges Deserve Even Bigger Solutions: Powerful Answers*, 2013 VERIZON COMM. INC. ANN. REP. 13.

¹⁷*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

net access is like a state putting a tollbooth on the Interstate Highway System which generally is prohibited.¹⁸

Indeed, there are a variety of Federal statutes that preempt state and local taxation in similar contexts. For example, 49 U.S.C 40116 prohibits states and localities from imposing a tax on “an individual or the transportation of an individual traveling in air commerce, the sale of air transportation or the gross receipts from that air commerce or transportation.” Other similar statutes prohibit taxation of interstate bus services and discriminatory taxation of railroads.¹⁹

Hearings

The Committee on the Judiciary held no hearings on H.R. 3086.

Committee Consideration

On June 18, 2014, the Committee met in open session and ordered the bill H.R. 3086 favorably reported without amendment, by a rollcall vote of 30 to 4, a quorum being present.

Committee Votes

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the Committee advises that the following rollcall votes occurred during the Committee’s consideration of H.R. 3086.

1. Mr. Conyers offered an amendment that would extend the moratorium for 4 years rather than make it permanent. The amendment was defeated 12 to 21.

ROLLCALL NO. 1

	Ayes	Nays	Present
Mr. Goodlatte (VA), Chairman		X	
Mr. Sensenbrenner, Jr. (WI)		X	
Mr. Coble (NC)		X	
Mr. Smith (TX)		X	
Mr. Chabot (OH)		X	
Mr. Bachus (AL)		X	
Mr. Issa (CA)		X	
Mr. Forbes (VA)		X	
Mr. King (IA)		X	
Mr. Franks (AZ)		X	
Mr. Gohmert (TX)		X	
Mr. Jordan (OH)		X	
Mr. Poe (TX)			
Mr. Chaffetz (UT)		X	
Mr. Marino (PA)		X	
Mr. Gowdy (SC)		X	
Mr. Labrador (ID)		X	
Ms. Farenthold (TX)			
Mr. Holding (NC)		X	

¹⁸ ROBERT S. KIRK, CONG. RESEARCH SERV., TOLLING OF INTERSTATE HIGHWAYS: ISSUE IN BRIEF (2013) (available at <http://www.fas.org/sgp/crs/misc/R42402.pdf>).

¹⁹ 49 U.S.C § 14505, 49 U.S.C § 11501.

ROLLCALL NO. 1—Continued

	Ayes	Nays	Present
Mr. Collins (GA)		X	
Mr. DeSantis (FL)			
Mr. Smith (MO)		X	
[Vacant].			
Mr. Conyers, Jr. (MI), Ranking Member	X		
Mr. Nadler (NY)	X		
Mr. Scott (VA)	X		
Ms. Lofgren (CA)		X	
Ms. Jackson Lee (TX)	X		
Mr. Cohen (TN)		X	
Mr. Johnson (GA)	X		
Mr. Pierluisi (PR)	X		
Ms. Chu (CA)	X		
Mr. Deutch (FL)			
Mr. Gutierrez (IL)			
Ms. Bass (CA)			
Mr. Richmond (LA)	X		
Ms. DelBene (WA)	X		
Mr. Garcia (FL)	X		
Mr. Jeffries (NY)	X		
Mr. Cicilline (RI)	X		
Total	12	21	

2. Motion to report H.R. 3086 favorably. Passed by a vote of 30 to 4.

ROLLCALL NO. 2

	Ayes	Nays	Present
Mr. Goodlatte (VA), Chairman	X		
Mr. Sensenbrenner, Jr. (WI)	X		
Mr. Coble (NC)	X		
Mr. Smith (TX)	X		
Mr. Chabot (OH)	X		
Mr. Bachus (AL)	X		
Mr. Issa (CA)	X		
Mr. Forbes (VA)	X		
Mr. King (IA)	X		
Mr. Franks (AZ)	X		
Mr. Gohmert (TX)	X		
Mr. Jordan (OH)	X		
Mr. Poe (TX)	X		
Mr. Chaffetz (UT)	X		
Mr. Marino (PA)	X		
Mr. Gowdy (SC)	X		
Mr. Labrador (ID)	X		
Ms. Farenthold (TX)	X		
Mr. Holding (NC)	X		
Mr. Collins (GA)	X		

ROLLCALL NO. 2—Continued

	Ayes	Nays	Present
Mr. DeSantis (FL)	X		
Mr. Smith (MO)	X		
[Vacant].			
Mr. Conyers, Jr. (MI), Ranking Member			
Mr. Nadler (NY)		X	
Mr. Scott (VA)		X	
Ms. Lofgren (CA)	X		
Ms. Jackson Lee (TX)			
Mr. Cohen (TN)	X		
Mr. Johnson (GA)	X		
Mr. Pierluisi (PR)	X		
Ms. Chu (CA)		X	
Mr. Deutch (FL)			
Mr. Gutierrez (IL)			
Ms. Bass (CA)			
Mr. Richmond (LA)	X		
Ms. DelBene (WA)	X		
Mr. Garcia (FL)	X		
Mr. Jeffries (NY)	X		
Mr. Cicilline (RI)		X	
Total	30	4	

Committee Oversight Findings

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee advises that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

New Budget Authority and Tax Expenditures

Clause 3(c)(2) of rule XIII of the Rules of the House of Representatives is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

Congressional Budget Office Cost Estimate

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the Committee sets forth, with respect to the bill, H.R. 3086, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
 CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 26, 2014.

Hon. BOB GOODLATTE, CHAIRMAN,
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3086, the “Permanent Internet Tax Freedom Act.”

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Melissa Merrell, who can be reached at 225-3220.

Sincerely,

DOUGLAS W. ELMENDORF,
 DIRECTOR.

Enclosure

cc: Honorable John Conyers, Jr.
 Ranking Member

H.R. 3086—Permanent Internet Tax Freedom Act.

As ordered reported by the House Committee on the Judiciary
 on June 18, 2014.

SUMMARY

H.R. 3086 would make permanent a moratorium on state and local taxes on Internet access and some taxes on electronic commerce. Under current law, the moratorium is set to expire on November 1, 2014. CBO estimates that enacting H.R. 3086 would have no impact on the Federal budget, but beginning in 2014, it would impose significant annual costs on some state and local governments. The bill would not affect Federal direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

By permanently prohibiting state and local government from collecting certain types of taxes, H.R. 3086 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the mandate would cause some state and local governments to lose revenue beginning in November 2014; those losses would exceed the threshold established in UMRA for intergovernmental mandates (\$76 million in 2014, adjusted annually for inflation) beginning in 2015. CBO estimates that the direct costs to states and local governments would probably total more than several hundred million dollars annually. The bill contains no private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO estimates that enacting H.R. 3086 would have no impact on the Federal budget.

PAY-AS-YOU-GO CONSIDERATIONS

None.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

The Internet Tax Freedom Act (ITFA), as amended, currently prohibits state and local governments from imposing taxes on Internet access and some taxes on electronic commerce until November 1, 2014. The ITFA also contains an exception to this moratorium, sometimes referred to as the grandfather clause, which allows some state and local governments to continue taxing Internet access if such tax was generally imposed and actually enforced prior to October 1, 1998. H.R. 3086 would make permanent the moratorium and eliminate the grandfather clause. Those changes constitute intergovernmental mandates as defined in UMRA because they would prohibit state and local governments from collecting taxes that they otherwise would collect, and in some cases, are currently collecting.

The primary effect of the bill would be the loss of state and local revenue starting in November 2014. UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues to comply with the mandate. Eliminating the grandfather clause would result in direct costs (in the form of forgone tax revenues) to those state and local governments that are currently collecting such revenues but would be precluded from doing so after H.R. 3086 is enacted.

While there is some uncertainty about the number of jurisdictions currently collecting affected taxes-and the precise amount of those collections-CBO believes that as many as seven states (Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Texas, and Wisconsin) and several local jurisdictions in those states are currently collecting such taxes. Information from four of those states indicates that the tax collections that would be prohibited total several hundred million dollars annually; those losses would exceed the threshold established in UMRA for intergovernmental mandates (\$76 million in 2014, adjusted annually for inflation) for each year, beginning in 2015.

It is possible that if the moratorium were allowed to expire as scheduled under current law, some state and local governments would enact new taxes or decide to apply existing taxes to Internet access and on electronic commerce during the next 5 years. It is also possible that some governments would repeal existing taxes or preclude their application to those services. Because such changes are difficult to predict, for the purposes of estimating the direct costs of the mandate, CBO considered only the revenues from taxes that are currently in place and actually being collected.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

This bill contains no private-sector mandates as defined in UMRA.

ESTIMATE PREPARED BY:

Federal Costs: Susan Willie
Impact on State, Local, and Tribal Governments: Melissa Merrell
Impact on the Private Sector: Amy Petz

ESTIMATE APPROVED BY:

Theresa Gullo
Deputy Assistant Director for Budget Analysis

Duplication of Federal Programs

No provision of H.R. 3086 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

Disclosure of Directed Rule Makings

The Committee estimates that H.R. 3086 specifically directs to be completed no specific rule makings within the meaning of 5 U.S.C. 551.

Performance Goals and Objectives

The Committee states that pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, H.R. 3086, makes permanent an existing moratorium that bars state and local governments from taxing Internet access or placing multiple or discriminatory taxes on Internet commerce.

Advisory on Earmarks

In accordance with clause 9 of rule XXI of the Rules of the House of Representatives, H.R. 3086 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(e), 9(f), or 9(g) of Rule XXI.

Section-by-Section Analysis

The following discussion describes the bill as reported by the Committee.

Sec. 1. Short title

Section 1 sets forth the short title of the bill as the Permanent Internet Tax Freedom Act.

Sec. 2. Permanent Moratorium

(a) Strikes the end date in the existing moratorium (47 U.S.C. 151 note) rendering it permanent.

(b) Effective Date—The date of enactment.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets and existing law in which no change is proposed is shown in roman):

INTERNET TAX FREEDOM ACT

(Public Law 105–277; 112 Stat. 2681–719; 47 U.S.C. 151 note)

* * * * *

DIVISION C—OTHER MATTERS

* * * * *

TITLE XI—MORATORIUM ON CERTAIN TAXES

SEC. 1100. SHORT TITLE.

This title may be cited as the “Internet Tax Freedom Act”.

SEC. 1101. MORATORIUM.

(a) MORATORIUM.—No State or political subdivision thereof may impose any of the following taxes [during the period beginning November 1, 2003, and ending November 1, 2014]:

(1) * * *

* * * * *

Dissenting Views

INTRODUCTION

H.R. 3086, the “Permanent Internet Tax Freedom Act,” makes the Internet Tax Freedom Act¹ permanent and ends the Act’s grandfather protections that apply to certain states. As a result, the legislation will substantially reduce revenues for those states. In fact, the Congressional Budget Office estimates that H.R. 3086 will cost states “several hundred million dollars annually” in lost revenues.²

Citing these problems and other concerns presented by the bill, the National Governors Association, the National Association of Counties, the National League of Cities, the U.S. Conference of Mayors, the Federation of Tax Administrators, the League of California Cities, the California State Association of Counties, the International City/County Management Association, the Government Finance Officers Association, the National Association of Telecommunications Officers and Advisors, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), the American Federation of State, County and Municipal Employees (AFSCME), the American Federation of Teachers (AFT), the American Federation of Government Employees (AFGE), the Communication Workers of America (CWA), the Department for Professional Employees (DPE), the International Association of Fire Fighters (IAFF), the International Federation of Professional and Technical Engineers (IFPTE), the International Union of Police Associations (IUPA), the National Education Association (NEA), the Services Employees Union International (SEIU), the United Food

¹Pub. L. 105–277, div. C, tit. XI (1998), 112 Stat. 2681–719, as amended (codified in 47 U.S.C. § 151 note (2014)).

²Congressional Budget Office Cost Estimate: Permanent Internet Tax Freedom Act, H.R. 3086, 113th Cong. (June 26, 2014) (emphasis added).

and Commercial Workers International Union (UFCW), and the Multistate Tax Commission oppose H.R. 3086.³

For these reasons, and those discussed below, we respectfully dissent and urge our colleagues to reject this seriously flawed legislation.

DESCRIPTION AND BACKGROUND OF H.R. 3086

H.R. 3086 makes permanent the Internet Tax Freedom Act (ITFA or Act) by striking the language in current law that specifies the expiration date of the Act's temporary moratorium, which currently is November 1, 2014. The bill also eliminates the Act's current grandfather protections for states that had in effect, as of the Act's original enactment date in 1998, laws taxing Internet access. The bill makes no other changes to current law.

When enacted in 1998, the ITFA was originally intended to prevent the potential stifling of the Internet and to foster the growth of electronic commerce.⁴ It did so by: 1) establishing a 3-year moratorium to prevent state and localities from imposing new taxes on Internet access; 2) prohibiting multiple states from taxing the same electronic commerce transaction; and 3) ensuring that commerce over the Internet would not be singled out for new discriminatory tax treatment. Nevertheless, Congress also understood that while encouraging the development of the Internet and its related industries, it should balance the interests of state and local governments to collect revenue. For that reason, the ITFA included a grandfather clause to protect the state and local Internet access taxes in effect prior to the enactment of the Act. In adherence to this guidance, subsequent Congresses have extended the Act's temporary moratorium, revised definitions, and have expanded or extended certain grandfather protections.⁵

CONCERNS WITH H.R. 3086

I. H.R. 3086 Ignores the Evolution of the Internet Since 1998

The ITFA was intended as a temporary measure to assist and nurture the fledgling Internet that back in 1998 was still in its commercial infancy. In apparent oblivion to the significantly changed environment that surrounds today's Internet, H.R. 3086

³Press Release, Nat'l Governors Ass'n, Regarding Internet Access Tax (June 17, 2014), available at <http://nga.org/cms/sites/NGA/home/news-room/news-releases/2014—news-releases/col2-content/nga-statement-regarding-intern-2.html>; Letter from the League of Cal. Cities Exec. Dir. Christopher McKenzie & the Cal. State Ass'n of Counties Exec. Dir. Matt Cate to Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 17, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff); Letter from the Nat'l Ass'n of Counties, *et al.* to Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 17, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff); Letter from the Am. Fed'n of Labor and Cong. of Indus. Org. (AFL-CIO), *et al.* to Members of the H. Comm. on the Judiciary (June 17, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff); Letter from the Fed'n of Tax Adm'rs President David M. Sullivan to Rep. Bob Goodlatte, Chair of the H. Comm. on the Judiciary, & Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 19, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff); Letter from the Multistate Tax Comm'n Exec. Dir. Joe Huddleston to Rep. Bob Goodlatte, Chair of the H. Comm. on the Judiciary, & Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 23, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff).

⁴H.R. Rep. No. 105-570, pt. 1, at 7 (1998); H.R. Rep. No. 105-570, pt. 2, at 2 (1998).

⁵The Internet Tax Nondiscrimination Act, Pub. L. No. 107-75, 115 Stat. 703 (2001), extended the moratorium until November 1, 2003. The Internet Tax Nondiscrimination Act, Pub. L. No. 108-435, 118 Stat. 2615 (2004), extended the moratorium until November 1, 2007 and reimposed the moratorium retroactively to November 1, 2003. The Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, 121 Stat. 1024-1026 (2007), extended the moratorium until November 1, 2014.

still regards this technology as emerging and in need of extraordinary protection in the form of exemption from state taxation.

In many respects, the Internet of 2014 is nearly unrecognizable from its 1998 predecessor. Today's Internet is considerably different in terms of both the extent of accessibility and the accompanying technology.⁶ What started as primarily a dial-up service available through a handful of providers, the Internet of today is nearly universally available through thousands of Internet service providers using technologies ranging from high-speed broadband cable or Digital Subscriber Line services, to wireless, satellite, fiber optics, and even broadband Internet access over power lines. This evolution has helped the Internet spawn major innovation initiatives and create myriad new industries.

In recognition of the fact that the Internet's pace of innovation would be complex and ever-changing technologically, Congress intentionally made the original moratorium temporary to ensure that Congress, industry, and state and local governments would be able to monitor the issue and make adjustments where necessary to accommodate new technologies and market realities. With continued questions as to the scope of the moratorium, the ongoing evolution of the Internet and its developing role in commerce, a permanent moratorium is unwise. A temporary moratorium, on the other hand, allows Congress to exercise its oversight and legislative authority over the ITFA.⁷ Indeed, it was because of the temporary nature of the Internet tax moratorium that Congress was able in 2007 to update the law's definition of Internet access, which had not changed significantly since the Act's enactment in 1998.

Further, one of the original goals of the ITFA—to foster electronic commerce by protecting it from multiple and discriminatory taxation—has already been met as evidenced by the explosion of commercial transactions over the Internet.⁸ The Internet is no longer a nascent development in need of Federal tax protection to grow. It is now a prosperous sector of the global economy. Thus, the reasons that initially warranted a moratorium simply no longer apply.

II. H.R. 3086 Will Devastate State Revenues, Thereby Potentially Forcing States to Cut Essential Services and Increase Taxes for Consumers and Businesses

H.R. 3086 will severely impact the immediate revenues for the grandfather protected states and all states progressively in the long term. As noted earlier, the CBO estimates that H.R. 3086 “would impose significant annual costs on some state and local governments”⁹ and far exceed the Unfunded Mandates Reform Act threshold of \$76 million in 2014.¹⁰ As the CBO explained, “the direct costs to states and local governments would probably total

⁶See Henry J. Reske, Ending Internet Law's Grandfather Clause Could Cost States \$500 Million, TAX ANALYSTS, June 24, 2014.

⁷Letter from Jeffrey L. Esser, Exec. Dir. of the Gov't Fin. Officers Ass'n (Apr. 7, 2014) (on file with H. Comm. on the Judiciary, Democratic Staff).

⁸See *Exploring Alternative Solutions on the Internet Sales Tax Issue: Hearing Before the H. Comm. on the Judiciary*, 113th Cong. (2014).

⁹Congressional Budget Office Cost Estimate, *supra* note 2.

¹⁰The Unfunded Mandates Reform Act is intended to curb the practice of imposing Federal mandates on state and local governments without adequate funding. Unfunded Mandates Reform Act of 1995, Pub. L. No. 104-4, 109 Stat. 48 (1995).

more than several hundred million dollars annually.” Not surprisingly, the Federation of Tax Administrators estimates that H.R. 3086 would lead to at least \$500 million in lost revenue per year from the states that currently are protected by the grandfather clause.¹¹ Specifically, “[if] the grandfather clause is eliminated, Texas would be hit the hardest” losing \$358 million a year in revenue, Wisconsin would lose about \$127 million per year, Ohio would lose about \$65 million per year, and South Dakota would lose about \$13 million per year.¹² Separately, the League of California Cities and the California State Association of Counties estimate that the bill would cost California municipalities over \$500 million.¹³

H.R. 3086 will restrain the states’ ability to cope with economic downturns and deficits in several respects. First, the legislation will deny all states the flexibility to raise revenue from one sector of the economy. Second, H.R. 3086’s inflexible effective date (November 1, 2014) fails to take into consideration that it occurs during the grandfather protected states’ fiscal years, and may not give them sufficient time to adjust their budgetary commitments to take into consideration the expected revenue losses.¹⁴ At the markup, Ranking Member John Conyers, Jr. offered an amendment to extend the moratorium and the grandfather protections for 4 years, which would have given sufficient time for state governments to plan accordingly.¹⁵ This amendment, however, was defeated.¹⁶ Third, H.R. 3086 will hinder the states’ ability to balance their budgets, especially the grandfather protected states. Most states are required, either statutorily or constitutionally, to balance their state budgets which typically are based on anticipated revenue and spending for the fiscal cycle.¹⁷ When revenue declines or spending increases during the fiscal cycle, states begin to run a deficit which means cutting spending or raising taxes.

If state and local governments choose to cut spending, then essential government services—such as educating our children, maintaining needed transportation infrastructure, and providing essential public health and safety services—will suffer. If state and local governments choose to raise taxes, then they would be forced to shift the tax burden onto other taxpayers, such as retailers, consumers, and homeowners, through increased property, income, and sales taxes. In sum, H.R. 3086 will burden taxpayers while excluding an entire industry from paying their fair share of taxes.

Instead of limiting the tax base for state and local governments, Congress should be focusing on meaningful ways to help state and

¹¹ Letter from the Fed’n of Tax Adm’rs President David M. Sullivan to Rep. Bob Goodlatte, Chair of the H. Comm. on the Judiciary, and Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 19, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff).

¹² Henry J. Reske, *Ending Internet Law’s Grandfather Clause Could Cost States \$500 Million*, TAX ANALYSTS, June 24, 2014.

¹³ Letter from the League of Cal. Cities Exec. Dir. Christopher McKenzie & the Cal. State Ass’n of Counties Exec. Dir. Matt Cate to Rep. John Conyers, Jr., Ranking Member of the H. Comm. on the Judiciary (June 17, 2014) (on file with the H. Comm. on the Judiciary, Democratic Staff).

¹⁴ H.R. 3086, § 2(b) (2013).

¹⁵ *The Permanent Internet Tax Freedom Act: Markup of H.R. 3086 Before the H. Comm. on the Judiciary*, 113th Cong. 11 (June 18, 2014) (amendment of Ranking Member John Conyers, Jr.).

¹⁶ The amendment failed by a roll call vote of 12–21. *Id.* at 50.

¹⁷ NAT’L ASS’N OF STATE BUDGET OFFICERS, *BUDGET PROCESSES IN THE STATES* 40 (Summer 2008).

local governments and by extension, taxpayers and local retailers. One such approach is by passing legislation that would address the remote sales tax issue. The Senate has already acted by passing the Marketplace Fairness Act of 2013.¹⁸ Under that bill, remote sellers who currently do not collect sales taxes would be incentivized through free tax collection software and services to collect the taxes and remit them to the states in which they are due. That bill would also require states to simplify several procedures which will benefit retailers. Such legislation could help states and local governments collect the over \$23 billion in estimated uncollected sales taxes each year.¹⁹

Not only do state and local governments suffer, local retailers—who have to collect sales taxes—are increasingly losing to out-of-state businesses that do not collect these taxes. Retail competitors should be able to compete on a level playing field with their Internet counterparts at least with respect to sales tax policy. The House should do its part and address the remote sales tax disparity before the end of this Congress.

CONCLUSION

H.R. 3086 is misguided legislation that will devastate state revenues especially for those states currently protected by the grandfather clause, could force state governments to eliminate essential governmental programs and services, and burden taxpayers. For all of these reasons, we respectfully dissent.

JOHN CONYERS, JR.
 JERROLD NADLER.
 ROBERT C. “BOBBY” SCOTT.
 SHEILA JACKSON LEE.
 JUDY CHU.
 DAVID N. CICILLINE.



¹⁸ See H.R. 743, 113th Cong. (2013) (as passed by Senate, May 6, 2013).

¹⁹ See *Exploring Alternative Solutions on the Internet Sales Tax Issue: Hearing Before the H. Comm. on the Judiciary*, 113th Cong. 212 (2014) (Written statement of Nat’l Governors Ass’n, et al.).