AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

# INTERNET TAX FREEDOM ACT

## HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JULY 26, 2007

**Serial No. 110–136**

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

37–009 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

## COMMITTEE ON THE JUDICIARY

JOHN CONYERS, JR., Michigan, *Chairman*

HOWARD L. BERMAN, California
RICK BOUCHER, Virginia
JERROLD NADLER, New York
ROBERT C. "BOBBY" SCOTT, Virginia
MELVIN L. WATT, North Carolina
ZOE LOFGREN, California
SHEILA JACKSON LEE, Texas
MAXINE WATERS, California
WILLIAM D. DELAHUNT, Massachusetts
ROBERT WEXLER, Florida
LINDA T. SÁNCHEZ, California
STEVE COHEN, Tennessee
HANK JOHNSON, Georgia
BETTY SUTTON, Ohio
LUIS V. GUTIERREZ, Illinois
BRAD SHERMAN, California
TAMMY BALDWIN, Wisconsin
ANTHONY D. WEINER, New York
ADAM B. SCHIFF, California
ARTUR DAVIS, Alabama
DEBBIE WASSERMAN SCHULTZ, Florida
KEITH ELLISON, Minnesota

LAMAR SMITH, Texas
F. JAMES SENSENBRENNER, JR., Wisconsin
HOWARD COBLE, North Carolina
ELTON GALLEGLY, California
BOB GOODLATTE, Virginia
STEVE CHABOT, Ohio
DANIEL E. LUNGREN, California
CHRIS CANNON, Utah
RIC KELLER, Florida
DARRELL ISSA, California
MIKE PENCE, Indiana
J. RANDY FORBES, Virginia
STEVE KING, Iowa
TOM FEENEY, Florida
TRENT FRANKS, Arizona
LOUIE GOHMERT, Texas
JIM JORDAN, Ohio

PERRY APELBAUM, *Staff Director and Chief Counsel*
JOSEPH GIBSON, *Minority Chief Counsel*

---

## SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

LINDA T. SÁNCHEZ, California, *Chairwoman*

JOHN CONYERS, JR., Michigan
HANK JOHNSON, Georgia
ZOE LOFGREN, California
WILLIAM D. DELAHUNT, Massachusetts
MELVIN L. WATT, North Carolina
STEVE COHEN, Tennessee

CHRIS CANNON, Utah
JIM JORDAN, Ohio
RIC KELLER, Florida
TOM FEENEY, Florida
TRENT FRANKS, Arizona

MICHONE JOHNSON, *Chief Counsel*
DANIEL FLORES, *Minority Counsel*

# CONTENTS

JULY 26, 2007


Page

OPENING STATEMENT

The Honorable Linda T. Sánchez, a Representative in Congress from the State of California, and Chairwoman, Subcommittee on Commercial and Administrative Law ..... 1
The Honorable Chris Cannon, a Representative in Congress from the State of Utah, and Ranking Member, Subcommittee on Commercial and Administrative Law ..... 2

WITNESSES

The Honorable Anna G. Eshoo, a Representative in Congress from the State of California
Oral Testimony ..... 5
Prepared Statement ..... 7
The Honorable John Campbell, a Representative in Congress from the State of California
Oral Testimony ..... 8
Ms. Meredith Garwood, Vice President, Tax Policy, Time Warner Cable
Oral Testimony ..... 17
Prepared Statement ..... 19
Mr. David C. Quam, Director of Federal Relations, National Governors Association
Oral Testimony ..... 24
Prepared Statement ..... 25

LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING

Prepared Statement of the Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, Chairman, Committee on the Judiciary, and Member, Subcommittee on Commercial and Administrative Law ..... 3
Prepared Statement of the Honorable Steve Cohen, a Representative in Congress from the State of Tennessee, and Member, Subcommittee on Commercial and Administrative Law ..... 4
Prepared Statement of the Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Ranking Member, Committee on the Judiciary ..... 4
H.R. 1077, a bill to amend the Internet Tax Freedom Act to make permanent the moratorium on certain taxes relating to the Internet and to electronic commerce, submitted by the Honorable John Campbell, a Representative in Congress from the State of California ..... 11
Editorial from the *Wall Street Journal* submitted by the Honorable Chris Cannon, a Representative in Congress from the State of Utah, and Ranking Member, Subcommittee on Commercial and Administrative Law ..... 37

Page

## APPENDIX

### Material Submitted for the Hearing Record

Responses to Post-Hearing Questions submitted by the Honorable Linda T. Sánchez, a Representative in Congress from the State of California, and Chairwoman, Subcommittee on Commercial and Administrative Law, to Meredith Garwood, Vice President, Tax Policy, Time Warner Cable ..... 40
Responses to Post-Hearing Questions submitted by the Honorable Linda T. Sánchez, a Representative in Congress from the State of California, and Chairwoman, Subcommittee on Commercial and Administrative Law, to David C. Quam, Director of Federal Relations, National Governors Association ..... 42
Prepared Statement of Joe Huddleston, Executive Director, Multistate Tax Commisssion ..... 44

# INTERNET TAX FREEDOM ACT

**THURSDAY, JULY 26, 2007**

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

The Subcommittee met, pursuant to notice, at 10:15 a.m., in room 2141, Rayburn House Office Building, the Honorable Linda T. Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Conyers, Lofgren, Delahunt, Watt, Cohen, Cannon and Feeney.

Staff Present: Norberto Salinas, Majority Counsel; Adam Russell, Majority Professional Staff Member; and Stewart Jeffries, Minority Counsel.

Ms. SÁNCHEZ. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, will come to order. And I would now recognize myself for a short statement.

Over 2 months ago this Subcommittee held an oversight hearing on the Internet tax moratorium. The hearing provided Members of this Subcommittee with the opportunity to learn more about the issues the current Internet Tax Freedom Act addresses. We heard opposing views regarding whether Congress should impose a permanent moratorium, a temporary moratorium or no moratorium at all. We heard arguments for and against the continuation of grandfather protections for those States that had already imposed taxes on Internet access prior to the implementation of current law. And most importantly, we heard contentious differences regarding the definition of Internet access.

Now that we have gained a deeper understanding of the issues in this debate, it is time for us to consider the different legislative approaches to the Internet tax moratorium, which is scheduled to end, without congressional intervention, on November 1, 2007.

The purpose of today's legislative hearing is to examine different legislative approaches to the intricacies of the Internet tax moratorium. Specifically, two of our House colleagues are here to testify today about their legislation to make the Internet tax moratorium permanent. Our other two witnesses will discuss the legislation and other legislative answers to this question.

As we hear today's testimony, let us remember how Congress approached the original Internet Tax Freedom Act, which was enacted in 1998, as well as subsequent developments in the information technology industry. Congress understood that when consid-

ering a moratorium on taxing Internet access, it should balance the interests of State and local government to collect revenue while encouraging the development of the Internet and its related industry. Congress also justified the moratorium as a temporary solution to provide time for administrative and definitional issues to be addressed regarding the fledgling industry.

However, since 1998, that once-fledgling industry has grown, and in 2006 was deemed to be worth an estimated $108.7 billion. And it is almost certainly worth more today. What was still seen as a novelty by some in 1998 has become a daily part of life at home, in school and in the workplace.

To help us explore these issues, we have invited four witnesses for this hearing this morning. I am pleased to have from my home State, both Representative Anna Eshoo from the 14th Congressional District of California and Representative John Campbell from the 48th District of California on our first panel to discuss the Internet tax moratorium legislation that each has introduced in this Congress.

For our second panel, we have Meredith Garwood, Vice President for Tax Policy at Time Warner Cable; and David C. Quam, Director of Federal Relations at the National Governors Association.

I want to emphasize that today's testimony is very important for our understanding of the legislation. Accordingly, I look forward to hearing today's testimony and welcome a thorough discussion of the issues and the legislation.

At this time, I would now like to recognize my colleague, Mr. Cannon, the distinguished Ranking Member of the Subcommittee, for any opening remarks he may have.

Mr. CANNON. Thank you, Madam Chair.

Today, we are having our second hearing on the implications of extending the Internet tax moratorium. Almost 10 years ago, Congress made the decision to protect the Internet access and trade from discriminatory taxes. I think that was a wise decision. It has led to the prospering of eCommerce beyond what anyone could have imagined. And now we have to ask ourselves whether it makes sense to continue that prosperity indefinitely.

There are two bills, H.R. 743 and H.R. 1077, that would remove the sunset provisions of the Internet tax moratorium and forever prevent States and localities from imposing discriminatory taxes on eCommerce. I am pleased that the sponsors of those bills, Representative Eshoo and Representative Campbell, are here with us today. They will tell us, along with Ms. Garwood, why a permanent end to the discriminatory taxes will help guarantee America's place as a leader of Internet commerce in the global economy and continue to act as a boon to the American consumer.

Both bills will allow the current grandfather exceptions to the Internet tax moratorium to expire. One of the bills, H.R. 1077, would go further by eliminating the grandfather exceptions from the law entirely. Three out of our four witnesses here will again testify why it is time for these grandfather clauses to expire, given that the States have had almost 10 years to wean themselves from the revenue from the discriminatory taxes that are protected under these clauses.

These three witnesses are not alone on these points. Almost 150 Members of the House of Representatives from both parties have cosponsored either one or both of these bills. That is a strong showing.

Against such a strong showing, I am happy that we have a Representative from the States who will present the counterarguments. I don't think he has the best of those arguments, but I respect his willingness to be the lone voice of dissent on this panel. I also look forward to his testimony, as well as that of Ms. Garwood, on the issue of the definition of Internet access.

One of the issues at our last hearing was that some States were attempting to tax some forms of Internet access, notwithstanding the clear intent of Congress to the contrary. On the other hand, we also heard from the States about their concerns that certain companies may attempt to bundle certain goods and services that would ordinarily be taxable with Internet access in an attempt to make those goods and services untaxable.

I understand that the States and representatives in the industry have been working to create a definition for Internet access that would address both of these concerns. And I look forward to hearing what progress has been made in that regard.

Finally, Madam Chair, keeping Internet commerce and access free from discriminatory taxes has been a success for the American economy. I hope that we will move soon to mark up this legislation and get it passed prior to the November expiration date.

Thank you, Madam Chair, and I yield back.

Ms. SÁNCHEZ. I thank the gentleman for his statement. We may be visited very shortly by Mr. Smith and Mr. Conyers. Without objection, all other Members' opening statements will be included in the record.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Today we revisit an issue that previous Congresses have dealt with during the last ten years. The Internet tax moratorium is a serious issue that Congress will have to address before November 1, when the current moratorium expires.

In May this Subcommittee held an oversight hearing on this issue so that we could learn how the current moratorium has affected state and local revenues and whether it increased the opportunities for every American to access the Internet. What we learned is that we face the same issues that previous Congresses have faced. What the witnesses told us at that hearing was that the moratorium has a negative affect on the revenues of state and local governments. The witnesses also told us that the United States has fallen behind many other industrialized countries in broadband deployment during the last four years.

The witnesses testified that the definition of "Internet access" was a major problem with the current moratorium. Since that time I have learned that the state and local governments and the industry representatives have worked together on that definition. And I thank them for doing so.

As we hear from our witnesses today, we will hear about how the introduced legislation on the Internet tax moratorium affects them and why they support or oppose it. I look forward to the representative of the states and local governments to tell us why the moratorium should be temporary and why Congress should continue to protect the states and local governments with a grandfather provision. I look forward to hearing from the representative of the industry why it and the state governments worked together on a such a contentious definition as "Internet access." And most importantly, I welcome testimony from two of my esteemed Members of Con-

gress on why they proposed legislation to make the Internet tax moratorium permanent.

The issues we are examining today go to the heart of state's rights to collect taxes as well as the interests of people to have access to the Internet. We should not forget how our actions in Congress affect the revenues of state and local governments. But we must balance all of the interests going forward when we consider legislation on the Internet tax moratorium.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

I am a co-sponsor of H.R. 743, the "Permanent Internet Tax Freedom Act of 2007," because there should be no obstacles to Internet access, nor should there be multiple or discriminatory taxes on Internet transactions. While proponents of repeal or of a temporary moratorium contend that the amount of Internet access tax would be minimal, any state or local tax on Internet access, however minimal, would have a disproportionate impact on lower income individuals—the last group of people who need obstacles to Internet access. Moreover, states and localities do not appear to have suffered catastrophic, or even notable, financial loss as a result of the moratorium that has been in place since 1998. While I understand the states and localities can always use additional sources of revenue and I sympathize with their situation, I believe that the balance of public interest in this case weighs in favor of a permanent Internet tax moratorium. Moreover, I would support elimination or expiration of the grandfather provision in the Internet Tax Freedom Act because a permanent moratorium on Internet taxes should apply to all states equally. I urge my colleagues to join me and the other 135 co-sponsors of H.R. 743 in supporting this legislation.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND RANKING MEMBER, COMMITTEE ON THE JUDICIARY

Madame Chair, in the absence of congressional action, the Internet tax moratorium will expire next November 1.

This legislation, which was initially enacted in 1998, prevents states or localities from imposing a sales tax that applies only to Internet transactions.

Internet commerce has yet to approach its full potential. The imposition of discriminatory taxes would threaten the future growth of e-commerce and would discourage companies from using the Internet to conduct business. Internet taxation would also create new regional and international barriers to global trade.

I have long supported a permanent extension of the moratorium on discriminatory Internet taxes and to end the grandfathered exemptions.

I was a co-sponsor of the House-passed version of this bill in the 108th Congress, and I am now a co-sponsor H.R. 743, the "Permanent Internet Tax Freedom Act of 2007."

I hope that we will move to extend the Internet tax moratorium for as long a period as we can as soon as we can.

I trust that such measures will continue to enjoy the broad bipartisan support they have in the past, and I hope that we can successfully move a bill soon without any extraneous provisions attached.

Ms. SÁNCHEZ. Without objection, the Chair will be authorized to declare a recess of the hearing at any point.

I am now pleased to introduce the witnesses on our first panel for today's hearing. Our first witness is Congresswoman Anna Eshoo of the 14th District of California. Ms. Eshoo was first sworn in as a Member of the House of Representatives in 1993, and since then has continued to defend the right of consumers and promote American competitiveness and innovation.

Ms. Eshoo serves on the House Energy and Commerce Committee, Subcommittee on Telecommunications and the Internet,

and on the House Committee on Intelligence as Chairwoman of the Subcommittee on Intelligence Community Management.

Ms. Eshoo is the author of H.R. 743, the "Permanent Internet Tax Freedom Act of 2007."

Our second witness is Congressman John Campbell, representing the 48th District of California. Elected to Congress in December of 2005, Mr. Campbell champions fiscal responsibility. He serves as a Member of the House Committees on Financial Services, the Budget and Veterans' Affairs.

Mr. Campbell is the author of H.R. 1077, the "Internet Consumer Protection Act of 2007."

I want to thank you both for your willingness to participate in today's hearing, especially in light of the fact that your schedules can be very hectic. Without objection, any written statement that you have will be placed in its entirety into the record, and we would ask that you limit your oral remarks to 5 minutes.

I am sure you are both familiar with the lighting system. The green light signifies that you may begin your testimony and will have 5 minutes to testify, the yellow light warns you that you have a minute remaining, and the red light will warn you that you are out of time. If you are caught midsentence when the red light comes on, we would appreciate it if you could finish your thought and wrap up your testimony so that we can proceed with the hearing.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit.

With our understanding of the ground rules now settled, Ms. Eshoo, I would invite you to proceed with your testimony.

**STATEMENT OF THE HONORABLE ANNA G. ESHOO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Ms. ESHOO. Thank you, Madam Chairwoman, and distinguished Members of the Subcommittee. Especially, thanks to you, Madam Chairwoman, for not only the hearings, your interest, but also allowing us to be here today—Mr. Campbell, myself and others—to testify on this very important issue.

The bill that I have sponsored, H.R. 743, is the Permanent Internet Tax Freedom Act of 2007. It enjoys strong bipartisan support in the House with 138 cosponsors as of today, including 18 Members of the full Committee, the House Judiciary Committee.

I also want to recognize and thank—I am not going to call out all the names, but there are many Members in previous Congresses and this Congress that have worked on this effort, both sides of the aisle. And then I think the father of the effort over in the Senate, Senator Ron Wyden.

My legislation is very short and it is very simple. It strikes the beginning and the end dates of the current moratorium, making the moratorium permanent. That is what the legislation does. It is silent on the grandfathering issue that you commented on in your opening statement, Madam Chairwoman.

The legislation guarantees that the barriers created by taxation of Internet access and eCommerce would not be erected when the

current moratorium expires later this year, nor would the barriers arise in the future. So as we know the Internet today, that it is open, it would remain so.

I think that we use—there is a lot of jargon and terminology that hovers around so many issues that we deal with in the Congress. We talk about access. What access is, is an entrance fee. It is an entrance fee. So think of entering a building and having to pay an entrance fee every time you walk in, and you can apply that to thousands of situations. That is what it means.

Now, there is the certainty that innovators and start-ups are looking for—they always are, we all appreciate that—that which I believe and others believe only a moratorium can—a permanent moratorium can provide.

When this issue first arose to prominence in the late 1990's, in my congressional district, which includes, along with Congresswoman Lofgren, Silicon Valley, it was bustling with activity in the burgeoning Internet sector. In just 1 year, from 1997 to 1998, the number of Internet users more than doubled from 70 to approximately 150 million people. And the 2 millionth domain name was registered in May 1998.

In September 1998 a small, start-up company was born in a garage in Menlo Park, Google, Inc. I remember saying to Eric Schmidt, what kind of a name is that? Well, it certainly is a great brand around the world today.

Congress and President Clinton at that time recognized the promise of the Internet and the need to foster its growth and development by maintaining an open architecture with a very, very—with very limited barriers to entry.

A big concern was the potential for Internet access and services to become a target for taxation. We realized at the time that it wouldn't serve our economy or our country well to interfere with the exciting growth and we prohibited new and discriminatory taxes.

I think when you look at the data across the board, that we were spot on. We anticipated well and we see what has happened. The Internet is now, as you said, Madam Chairwoman, an integral part of everyday life. It has integrated itself into everything that we do. We can't even think of a day where, whether it is in communication, in commerce, in business, in education, in research where this doesn't apply.

I think if we reverse this, we will essentially kill what I call the "golden goose dot-com." I don't think it is acceptable for our country, the country that has led. And I see the applications of this at another Committee that I am on, at the House Intelligence Committee, of how this has served our country. So to impede this effort that has been successful, I think, is clearly the wrong direction. We would drive ourselves into the past, pre-1997-1998. And I think that this has served the American people well.

The threat of new Internet taxes will also impede innovation. You have to have some kind of certainty for people to make their investments, to develop the capital and to move forward. So we don't want to dampen this down.

For all of these reasons, obviously, I think, as well as many on both sides of the aisle believe, that it is important to enact a permanent moratorium.

The marvel of the Internet and the key element in its rapid growth has been the ability of any user, any business, to get onto the Net and reach any other user without paying what I call an entrance fee. So I think Congress needs to step up. This is an important debate.

I came out of—my original public service was in local government and county government. I know firsthand the restrictions that are there. I wish the States had come up with a standard, because we would be having a different conversation. But the threat of 1,000-2,000 taxing authorities in the country jumping on one pony I don't think, number one, is attractive; two, I don't think it is workable; three, there is a lot at stake when that becomes a major part of the conversation. We should have a conversation about it, but I think the overwhelming evidence points in this direction.

So I would be happy to answer questions, I am thrilled to be here. It is really nice to be at this end rather than up on the dais. It is a different experience. I welcome it. I thank you for it, Madam Chairwoman.

You are all my friends and colleagues, and it is an honor to testify before you.

Ms. SÁNCHEZ. Thank you for your testimony Ms. Eshoo. We appreciate your taking the time and your thoughtfulness with respect to the issues that we are grappling with in this Subcommittee.

[The prepared statement of Ms. Eshoo follows:]

PREPARED STATEMENT THE HONORABLE ANNA G. ESHOO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Thank you Madam Chairwoman for inviting me to testify today about my legislation, H.R. 743, the Permanent Internet Tax Freedom Act of 2007. This effort enjoys strong bipartisan support in the House, with *138 cosponsors* including 18 Members of the Judiciary Committee.

It's an honor to join with Representative Bob Goodlatte, a Member of this Committee and with my longtime friend and "father" of this effort in the Senate, Senator Ron Wyden.

My legislation is very short and very simple. It merely strikes the beginning and end dates of the current moratorium, thus making the moratorium permanent.

H.R. 743 would guarantee that the barriers created by taxation of Internet access and e-commerce would not be erected when the current moratorium expires later this year, nor would the barriers arise in the future.

This is the certainty that innovators and start-ups are looking for and which only a permanent moratorium can provide.

When this issue first rose to prominence in the late 1990's, my congressional district, home to Silicon Valley, was bustling with activity in the burgeoning Internet sector.

In just one year, from 1997 to 1998, the number of Internet users more than doubled from 70 to approximately 150 million, and the 2 millionth domain name was registered in May of 1998.

In September of '98 a small, start-up company was also "born" in a garage in Menlo Park—*Google, Inc.*

Congress and President Clinton recognized the promise of the Internet and the need to foster its growth and development by maintaining an open architecture with limited barriers to entry, and minimal regulatory and administrative burdens.

Of particular concern was the potential for Internet *access* and services to become a target for government taxing authorities looking for new sources of revenue.

We recognized at that time that it would not serve our country well to interfere with the growth of this exciting and invaluable tool for information, communica-

tions, and commerce, and we prohibited new and discriminatory taxes on the Internet.

The moratorium has served us well. The Internet is now an integral part of everyday life. Americans across the country utilize the Internet for communication, commerce, business, education and research.

If we reverse course now, we'll essentially kill GoldenGoose.com.

According to the most recent data, the U.S. now ranks 24th in broadband penetration among all industrialized countries.

This is simply not acceptable for the country that invented the Internet, and I'm proud to support a variety of efforts, including the Speaker's *Innovation Agenda,* which will rectify this deplorable situation.

I can think of few things we could do to impede this effort more than subjecting Internet access and e-commerce to new taxes. Our competitors realize that access to broadband is essential to be competitive in the 21st Century global economy, and they are heavily subsidizing it.

Allowing this moratorium to expire would do the opposite and disincentivize broadband access for *every* American.

These taxes are also inherently regressive and would hit low-income households the hardest, widening the breach of the "Digital Divide."

And the threat of new Internet taxes will also impede innovation and the development of new technologies and applications that will revolutionize business, healthcare, education and entertainment in our country, but only if all Americans have affordable access to advanced broadband service.

For all these reasons, it's essential to enact a permanent moratorium to remove this cloud over the Internet once and for all.

The marvel of the Internet and the key element in its rapid growth has been the ability of any user or business to get onto the Net and reach any other user without paying an "entrance fee" or imposing significant barriers.

It's critical for Congress to enact a permanent moratorium:

1. To reflect our commitment to universal broadband in America;
2. To provide certainty to the entire Internet community that access to the Net will remain tax free;
3. To ensure e-commerce will remain free of discriminatory taxes.

Thank you again Madam Chairwoman for the opportunity to testify today. I look forward to working with you to enact this important legislation.

Ms. SÁNCHEZ. At this point, I would invite Mr. Campbell to begin his testimony.

## STATEMENT OF THE HONORABLE JOHN CAMPBELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. CAMPBELL. Thank you Madam Chairwoman, Ranking Member Cannon and Members of the Committee. And I, too, appreciate the opportunity to be here and speak with you all about this important issue.

Now, I am the primary sponsor of H.R. 1077, but also cosponsor of Ms. Eshoo's bill. The only difference between them is whether there is a grandfather clause or not, whether you allow some entities, some local governments and so forth that have imposed taxes to keep them or not. Other than that they are identical; the spirit of them is identical. And frankly, although I would prefer the grandfather clause be removed, the important thing is that we make sure that from now, going forward, we don't impede the growth of the Internet; and I think that is really what we are talking about.

The Internet has been a tremendous vehicle for explosive growth both in the economy and in the ability of everyday people to access information and services that they, prior to the Internet, never had the opportunity to access.

Let me explain what both of these bills—and I will speak of them as a single unit at this point—what they don't do. And what they don't do is, they do not restrict the ability of States and local governments to impose regular taxes that are imposed on other transactions, whether they are on the Internet or not. They do not restrict the ability of States and local governments to impose, for example, sales taxes on transactions over the Internet. Those sorts of taxes that are independent of whether the triggering mechanisms on the Internet or not are not impeded by this bill.

What it does say is that you cannot impose a discriminatory tax. So you cannot have a sales tax on Internet transactions that are higher than a sales tax that that same jurisdiction imposes on a transaction at a brick and mortar facility. So it does say that.

What it also says, as my colleague from California pointed out, is that you can't impose a tax on access to the Internet. And that is the important thing here, because access to the Internet has become largely free, and as I will explain in a moment, is going to become freer. And it wasn't that long ago when most people paid $10, $15, $20 a month for access to their Internet service provider. Now, virtually all of those are entirely free. And so more and more people are able to access this tremendous source of information and opportunity without charge.

Now, can you imagine if some jurisdiction decides to put on something and says, well, we are going to charge you for each e-mail you send, or, well, we are going to charge you for the amount of time you are on the Internet, how that is going to restrict use of the Internet, both for individuals and how it will restrict the growth of commerce that has occurred over the Internet.

And that is what this bill is trying to say, that the marketplace is moving for the Internet to become freer and freer and freer; and let us not have government go in and start making it less and less and less free, and restricting the ability of people to get on and do what they want to do.

Now, in my home county of Orange County, CA, the city of Anaheim is in the process of putting together, and I believe they advertise that they will be the first city to do this, to have complete, public, free Wi-Fi throughout the entire city. So anyone with a computer, with Wi-Fi, who is anywhere in the city of Anaheim will be able to access the Internet, and since Internet service providers are basically free, they will have complete, total free access if you are in the city of Anaheim.

I know there are a bunch of other cities now in other localities that are looking at this sort of thing. So when I say that it is free and getting freer, that is what I mean, that increasingly the benefits of eCommerce and the benefits of being able to access the Internet are outweighing the necessity or the ability of charging for e-mail addresses or for e-mail access or for access at all. So the last thing in the world we ought to be doing is restricting that by taking that and adding some kind of a tax or some kind of a charge at the city or local level.

So that is really what this bill is about, what these bills are about, what the spirit of these bills are about. And the benefits are both that—for both commerce and the fact that people will be able to access, have freer access to more information and more com-

merce and more things that they have never been able to do, in the future.

And as my colleague from California said some years ago, very few of us, certainly not me, but I think the ones who did anticipate where the Internet was going to be have a whole lot more money than any of us do at this point.

But—it is hard to anticipate where it will be 10 years from now, but the one thing we do want to do is make sure that we don't stand in the way of this great engine of growth, opportunity and access growing to wherever it may grow.

And it is great to be with you and I will yield back Madam Chairwoman.

[The bill, H.R. 1077, follows:]

I

110TH CONGRESS
1ST SESSION

# H. R. 1077

To amend the Internet Tax Freedom Act to make permanent the moratorium on certain taxes relating to the Internet and to electronic commerce.

---

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 15, 2007

Mr. CAMPBELL of California (for himself, Mr. DANIEL E. LUNGREN of California, Mr. CANTOR, Mr. FEENEY, Mr. GOODE, Mr. GOHMERT, Mr. PRICE of Georgia, Mr. DOOLITTLE, Mr. LAMBORN, Mr. SALI, Mr. GOODLATTE, Ms. ZOE LOFGREN of California, Mr. MILLER of Florida, Mr. MACK, Mr. GARRETT of New Jersey, Mr. GARY G. MILLER of California, Mr. SESSIONS, Mr. MCCARTHY of California, Mr. ROHRABACHER, Mrs. BLACKBURN, Mr. FOSSELLA, Mr. DREIER, Mr. PENCE, Mr. KLINE of Minnesota, Mr. WILSON of South Carolina, and Mr. BARRETT of South Carolina) introduced the following bill; which was referred to the Committee on the Judiciary

---

# A BILL

To amend the Internet Tax Freedom Act to make permanent the moratorium on certain taxes relating to the Internet and to electronic commerce.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Internet Consumer Protection Act of 2007".

**SEC. 2. AMENDMENTS TO THE INTERNET TAX FREEDOM ACT.**

The Internet Tax Freedom Act (47 U.S.C. 151 note) is amended—

(1) in section 1101(a) by striking "during the period beginning November 1, 2003, and ending November 1, 2007", and

(2) by striking section 1104.

○

Ms. SÁNCHEZ. I thank Mr. Campbell for his testimony.

We do have very few questions, so we are actually going to proceed under unanimous consent. I am going to ask unanimous consent to grant Mr. Cannon 3 minutes to ask a couple very quick questions. And I understand Ms. Lofgren will have a couple of quick questions as well.

Without objection, Mr. Cannon.

Mr. CANNON. Thank you, Madam Chair.

And I want to thank my two friends for being here and taking the initiative on this topic that is so very important.

I just wonder, and I don't know if you have even thought about these things, but associated issues are whether or not we are going to tax telephone numbers. If we do that, we are going to be regulating the Internet. When some people are talking about funding the universal service done by taxing telephone numbers, of course, that means to me that people will move away from telephone numbers and these other forms of identification.

But if you have thoughts about that, or also about whether municipalities ought to have the ability, whether we ought to preempt the laws that prohibit municipalities from building out fiber-optic networks as opposed to wireless networks, like you talked about in Anaheim, Mr. Campbell.

So if either of you has thoughts on either of those issues, I would love to hear them.

Ms. ESHOO. Well, I think we are at a juncture right now between what is—you know, all of the services that are merging, telephones have been taxed forever, telephone service has.

Now we are moving—we had a little conversation when we first came into the room about this. Now we are in an era where we are racing forward again, where so many services are merging. So all of that is going to have to be considered.

And you have to take a look at the services. I mean, myself, what I pay just monthly for all these different services, these get to be kind of expensive utility bills. I mean, there is a real investment in all of this.

So the Committee is going to have to make some kind of decision on that. I don't know whether it is sooner or a little farther down the road.

There is something that I failed to mention in my opening testimony, and that is the whole issue of broadband. You are going to have to consider broadband in this because it is part of the issue. Are we going to—as a Nation, we are now ranked, the latest data for our country is that we rank 24th in the world in broadband penetration. American people don't like that. We like being first, not 24th. And we continue to slip.

Now, what kind of an effect is this taxation issue, or not having a moratorium or permanent moratorium, what kind of effect is that going to have on broadband penetration in our country? So it is something else to be considered.

Mr. CAMPBELL. I agree with those comments. I will just add that I think some of those questions, as you say, have to do with the convergence of all these technologies, which really are outside the scope of this particular bill. Because now, as you know, you can get Internet on your cable TV and you can get telephone on your Inter-

net; and as all of these converge, then I think there are questions relative to that.

But I think what this bill is saying is that—don't tax the access of that Internet. You may tax things that you get from the Internet, like purchases, et cetera, et cetera, but don't tax the ability to get it in the first place.

And I think that is where we are coming from.

Mr. CANNON. Madam Chair, just a quick follow-up. When you say what you get on the Internet, that is like maybe a magazine or a pair of shoes, but if the service is bits and bytes, you don't want to tax that, right?

Mr. CAMPBELL. No, clearly you don't.

Mr. CANNON. So if those bits and bytes happen to be voice in a communication that is similar to a telephone, I take it your view is that should not be taxed.

Mr. CAMPBELL. I think you can actually have a view either way on that. But as long as you are not taxing the bit and the byte. If you are taxing the fact that there is a telephone there, I suppose that is something you can do; just don't tax the access to it.

Ms. SÁNCHEZ. The Congresswoman's time has expired. I would ask unanimous consent that Ms. Lofgren be granted 3 minutes for questioning without objection.

Ms. LOFGREN. Thank you. And I really appreciate it; I know how we are all busy and that the two of you would take time to share your thoughts here today really is important to me and to the whole Committee. And I am proud that the main authors are Californians because certainly high technology is very much associated with our State.

I just had two quick questions. The first has to do with definitions. And when we started this process in—I think it was the 105th—Commerce, the definition wasn't a major issue because we thought we knew. But, of course, things have morphed and converged, and I am proud to be a cosponsor.

But I am wondering whether we should have a further discussion to broaden the access, because when we look at our need to support the free flow of information in all the bits and bytes and data, you know, I think the broadest definition of access should be our guide. And I wonder if the two of you agree with that.

Ms. ESHOO. Well, it is certainly my intent as the author. But that is why we have hearings, that is why Members have discussions with each other when we go to the floor. All of that interaction, all of this interaction is very important.

I have tried, in many situations—and I don't think there is a set recipe for this; sometimes the language needs to be so broad because you don't want to get into definitions and hamper things. On the other hand, some bills really call for high definition. So I am open on that.

I think that, again, this is why we are here, why there is a discussion. I would like the principle set down by the Congress. We are having a great debate right now, so is the FCC, on spectrum. And this happens once every decade or less; and it is going to define, it is going to define the next, perhaps the first half century of the 21st century.

So this is a big decision of how we are going to move forward. So I am open to it. I mean, you are going to come up with ideas, and we will discuss them. I think the principle of the legislation is what I am the most concerned about keeping intact.

Mr. CAMPBELL. The same here; I agree with my colleague from California.

And the only thing I will just add is, again anticipating where this is going to go. You know, sending e-mails, sending a letter costs money, making a phone call costs money, sending an e-mail is free. Why is that?

Because of the advertising and other opportunities, there is a lot of money being made on the Internet now with free services because of advertising and other things that are going on. As we see these things, something goes up on YouTube and a million people look at it in 12 hours or so forth; as you see that kind of opportunity to get to people, there are going to be more things that now cost on the Internet or cost to get to that I think are going to increasingly be free because there is going to be so much opportunity to make money in other ways, because there are a million people looking at it.

So that is why I agree with you, the broadest definition possible, because I think that some things that now, just like before, where if you had said 10 years ago, you are going to be able to send an e-mail and it is going to be free. Are you nuts?

But I think there are things now that are going to be freer as time goes on. And that is where the broader the definition, the more opportunity we have for those things to grow that way.

Ms. LOFGREN. Just noting, Congresswoman Eshoo and I were both in local government. As a matter of fact, she was on the Board of Supervisors in San Mateo County at the same time I was on the Board of Supervisors in Santa Clara County, right next door. And we both understand the need for an adequate revenue base for local government and for States. And I am actually quite passionate about county government, as I know Ms. Eshoo is.

Having said that, the consequence of impeding the development of telecommunications is dire for the economy and ultimately will hurt the economy of the local government. So I am wondering—and this is just to Ms. Eshoo, because it is a Democratic question. We adopted as a caucus policy something called the Innovation Agenda. You and I were very intimately associated with the crafting of that Innovation Agenda, and it is a policy of the Democratic Caucus. That is our guide.

I went back and looked to see if there was a specific reference to this bill, and there isn't. But I believe that this issue is encompassed by that broad language of the Innovation Agenda. As one of the co-authors of that, I wonder if you have an opinion. I didn't tell you I was going to ask you this, so if you want to think about it, that would be fine.

Ms. ESHOO. I am so glad that you did. As a matter of fact, when I was preparing for this late last evening, I had that in there, but I needed to cut back on my—believe it or not, I did cut back on my comments.

But we spoke very specifically in the Innovation Agenda, as a full caucus policy position, on broadband. And that is, it is a huge consideration for both parties, for the Congress of the United States.

This is something that really can fully democratize the Internet. When you have a deep broadband penetration in a country, it serves everyone with a small "d". And when you look at—all you have to do is look at our competitors in the world and what they have done and what we are not doing. I mean it is a stark contrast; there is a reason why we are 24th.

So the concentration that we brought to designing those public policy goals in our Innovation Agenda, the principles of this, are embedded in it. Does it say specifically Internet access and taxation and that? No. We didn't drill down with language like that. It is up to us as legislators to enact the principles of it.

But thank you for raising it.

Ms. LOFGREN. Thank you very much, Madam Chairwoman.

Ms. SÁNCHEZ. We have also been joined by Mr. Conyers, a distinguished Member of the Subcommittee and the Chairman of the Judiciary Committee, of the whole Committee. I would ask unanimous consent to grant Mr. Conyers such time as he may consume.

Mr. CONYERS. I just wanted to say good morning to Anna Eshoo in public; and Broderick Johnson I see over there, who has worked with the Committee on and off across the years; and my colleague, Mr. Campbell. This is—well, if you were one, like me, who hadn't heard the testimony, it sounds like just about everybody is in agreement, mostly, that we have got to extend the moratorium and perhaps make it permanent.

Is that too simplistic?

Ms. ESHOO. No. I think—I am not going to add to that. I think you have an excellent impression, Mr. Chairman.

Thank you for your warm welcome and for the work that the Committee does.

Mr. CAMPBELL. And we should do it by November 1 because time is of the essence.

Mr. CONYERS. It expires, right?

Well, that takes care of Conyers this morning.

Ms. SÁNCHEZ. I think the briefest Member on this panel. I thank you for that, Mr. Chairman.

With that, I would like to thank the first panel for their testimony and excuse you to run off no doubt to more duties that you have as Members of Congress. Again, I want to thank for your time and for your thoughtfulness.

We will take a short recess to allow the second panel to get settled in. So if the second panel would please do that.

[Brief recess.]

Ms. SÁNCHEZ. The Subcommittee will now come to order for our second panel of witnesses. I am pleased to introduce the witnesses of our second panel for today's hearing.

Our first witness is Meredith Garwood, Vice President of Tax Policy for Time Warner Cable. Ms. Garwood represents Time Warner Cable in national and State tax organizations and projects and serves on the Tax Policy Committee for the Council on State Taxation.

Prior to joining Time Warner Cable, Ms. Garwood was the Senior Director of Tax with AT&T Wireless.

We want to welcome you today.

And our final witness is David Quam, Director of the Office of Federal Relations for the National Governors Association. Mr. Quam manages NGA's legal and advocacy efforts, working closely with governors, Washington, DC Representatives and NGA's standing committees to advance the association's legislative priorities.

Prior to working at NGA, Mr. Quam served as counsel on the U.S. Senate Subcommittee on the Constitution, Federalism and Property Rights for the Committee on the Judiciary.

We want to welcome you both.

And at this time, I would invite Ms. Garwood to please begin her testimony.

**STATEMENT OF MEREDITH GARWOOD, VICE PRESIDENT, TAX POLICY, TIME WARNER CABLE**

Ms. GARWOOD. Chairwoman Sánchez and Members of the Subcommittee, thank you for this opportunity to testify on an issue of real and growing importance to millions of consumers and businesses in the United States.

I also want to thank Representatives Eshoo and Campbell for their earlier testimony and for their leadership.

My name is Meredith Garwood, and I am the Vice President of Tax Policy for Time Warner Cable. I am responsible for pursuing Federal and State legislative tax initiatives that ensure fair and nondiscriminatory taxation for consumers of our services. I appear today on behalf of a broader coalition of Internet service providers, Internet backbone providers and Internet application and content providers. Our coalition is known as Don't Tax Our Web. On behalf of that coalition, let me extend our appreciation to Madam Chairwoman and to you Ranking Member Cannon for today's hearing.

Unless Congress acts, the Internet Tax Freedom Act will expire on November 1, 2007. This morning I would like to focus on three points. First, I urge Congress to make the moratorium permanent. Second, the moratorium should be clarified once and for all to prevent taxation of the transport component of Internet access, including the Internet backbone. Finally, the moratorium should be extended without any further extensions of existing taxes on Internet access that were grandfathered in 1998 and again in 2004.

H.R. 743 and H.R. 1077 encompass these objectives, and we strongly support both bills.

With regard to making the moratorium permanent; at a time when economic development experts are calling for increased deployment of broadband, new taxes on Internet access, including taxes on transport used to provide that access, will greatly increase the cost of that deployment.

It is hard to imagine that at some point in the future it will make sense to allow access to the Internet to be taxed by thousands of taxing jurisdictions. Indeed, even with the moratorium in place, companies in our coalition have had to deal with consequences of contrived loopholes in the Internet Tax Freedom Act—litigation, audit risk and class action lawsuits—but it is our strong position that access to the Internet should be available, as avail-

able, as affordable, as possible; and therefore we continue to seek a permanent ban.

That should be our permanent national policy. It is important that we make unmistakably clear that the moratorium applies to all Internet transport, including the Internet backbone.

The amendments to the Internet Tax Freedom Act in 2004 had two main objectives, one, to treat all technologies similarly, and two, to ensure that the Internet backbone remained free of tax. Many States like Massachusetts and North Carolina acted appropriately in issuing rulings consistent with the Federal law and Congress' intent that the Internet not be burdened by hidden taxes. Unfortunately, a few States, none of which were original grandfathered States, chose to ignore the changes made by the Congress in 2004. The actions of these States must be addressed because they undermine the moratorium, circumvent the will of the Congress and put pressure on other States to sidestep the moratorium.

From an economic standpoint, taxes on the transport components of Internet access are indistinguishable from taxes on Internet access. Both put the same upward pressure on end users' cost of service, deterring growth of Internet access subscribers. Additionally, new language to clarify this issue is important because we currently have companies facing class action lawsuits filed by their customers because the companies followed the rulings issued by these States.

Our coalition has been working with the Federation of Tax Administrators and with the National Governors Association in an effort to make unmistakably clear that the Internet backbone and other components of Internet transport are covered by the moratorium. We have also worked with the States to address their concerns that the definition of Internet access could unintentionally include products other than Internet access.

Our discussions with the States have led to an agreement between our coalition and both FTA and NGA on the definition of Internet access. We believe that our joint proposal will ensure that consumers do not bear the burden of taxes directly, as part of the price of Internet access, or indirectly, through unwarranted tax-driven increases in the price Internet access providers must pay for transport.

I want to express my appreciation to David Quam and to Harley Duncan of FTA for their constructive approach to this very challenging issue.

We must end the grandfathering of taxes on Internet access. In 1998 and again in 2004, Congress grandfathered taxation of Internet access in several States. Consumers in those States were deprived to the benefits of the lower-priced access to the information superhighway. Nearly a decade after a handful of States were grandfathered, it is time to bring these limited, temporary exceptions to a close and fulfill the original objective of a national policy against taxing Internet access.

Now is not the time to allow regressive new taxes to reverse the progress we are making in the Nation. Congress should ensure that all consumers in all States benefit from the moratorium.

Madam Chairwoman and Members of the Subcommittee, thank you again for this opportunity to testify; and I look forward to your questions.

Ms. SÁNCHEZ. Thank you, Ms. Garwood.

[The prepared statement of Ms. Garwood follows:]

PREPARED STATEMENT OF MEREDITH GARWOOD

**Written Testimony of Meredith Garwood**

**Vice President Tax Policy**
**Time Warner Cable**

**Before the Subcommittee on Commercial and Administrative Law**

**Committee on the Judiciary, U.S. House of Representatives**
**July 26, 2007**

Chairwoman Sanchez and Members of the Subcommittee, thank you for this opportunity to testify on an issue of real and growing importance to millions of consumers and businesses across the United States. I also want to thank Representatives Eshoo and Campbell for their earlier testimony and for their leadership.

My name is Meredith Garwood, and I am Vice President of Tax Policy for Time Warner Cable. I am responsible for pursuing federal and state legislative tax initiatives that ensure fair and non-discriminatory taxation for consumers of our services. I appear today on behalf of a broader coalition of Internet service providers, Internet "backbone" providers, and Internet application and content providers. Our Coalition is known as the "Don't Tax Our Web" Coalition. On behalf of that Coalition, let me extend our appreciation to you Madame Chair and to you Ranking Member Cannon for today's hearing.

Unless Congress acts, the Internet Tax Freedom Act will expire on November 1, 2007. This morning, I would like to focus on three points:

- First, I urge Congress to make the moratorium permanent.
- Second, the moratorium should be clarified once and for all to prevent taxation of the transport component of Internet access, including the Internet "backbone".

• Finally, the moratorium should be extended without any further extensions of existing taxes on Internet access that were grandfathered in 1998 and 2004.

H.R. 743 and H.R. 1077 both encompass these three objectives, and therefore our coalition strongly supports both bills.

**Make the Moratorium Permanent**

At a time when economic development experts are calling for increased deployment of broadband, new taxes on Internet access, including taxes on transport used to provide that access, will greatly increase the cost of that deployment.

It is hard to imagine that at some point in the future it will make sense to allow access to the Internet to be taxed by thousands of taxing jurisdictions. Indeed, even with the moratorium in place, companies in our coalition have had to deal with the consequences of contrived loopholes in the Internet Tax Freedom Act—litigation, audit risk, and class action lawsuits. But it is our strong position that access to the Internet should be as available and as affordable as possible, and therefore we continue to seek a permanent ban. That should be our permanent, national policy.

**Make Unmistakably Clear that the Moratorium Applies to All Internet Transport, Including the Internet "Backbone"**

The amendments to the Internet Tax Freedom Act in 2004 had two main objectives: (1) to treat all technologies similarly, and (2) to ensure that the Internet "backbone" remains free from tax. Many States like Massachusetts and North Carolina acted appropriately in issuing rulings consistent with the Federal law and Congress's clear intent that the Internet not be burdened by hidden taxes.

Unfortunately, a few States, none of which were original grandfathered States, chose to ignore the changes made by Congress in 2004. The actions of these errant States must be addressed because they undermine the moratorium, circumvent the will of Congress, and put pressure on other states to similarly sidestep the moratorium. From an economic standpoint, taxes on the transport components of Internet access are indistinguishable from taxes on Internet access. Both put the same upward pressure on end users' cost of service, deterring growth of Internet access subscribers.

Additionally, new language to clarify this issue is important because we currently have companies facing class action lawsuits filed by their customers because the companies followed the rulings issued by these states.

Our coalition has been working collaboratively with both FTA and NGA in an effort to make unmistakably clear that the Internet "backbone" and the other components of Internet transport are covered by the moratorium. We have also worked with the States to address their concerns that the definition of Internet access could unintentionally include products other than Internet access. Our discussions with the States have led to an agreement between our coalition and both FTA and NGA on the definition of "Internet access" that includes transport and excludes services that are unrelated to Internet access. We believe our joint proposal will ensure that consumers do not bear the burden of taxes whether directly as part of the price of Internet access or indirectly through unwarranted tax-driven increases in the price Internet access providers must pay for transport. I want to express my appreciation to David Quam and to Harley Duncan of FTA for their constructive approach to this very challenging issue.

**End the Grandfathering of Taxes on Internet Access**

In 1998 and again in 2004, Congress grandfathered the taxation of Internet access in several States. Consumers in those States were deprived of the benefits of lower priced access to the information superhighway. Nearly a decade after a handful of States were first granted these grandfather protections, it is time to bring these limited and temporary exceptions to a close and to fulfill the original objective of a national policy against taxing Internet access. There is abundant evidence that competition between different types of Internet access providers is lowering prices for consumers and making high-speed Internet access more accessible and affordable to consumers and small businesses. Now is not the time to allow regressive new taxes to reverse the progress we are making in this nation. The oft-mentioned "digital divide" is as much a concern for the economic growth of small business as it is for millions of consumers still beyond the reach of the broadband economy. Congress can take an important step in eliminating this gulf by ensuring that consumers in all States benefit from the moratorium.

Madame Chair and members of the Subcommittee, thank you again for the opportunity to testify and I look forward to your questions.

Ms. SÁNCHEZ. Mr. Quam, would you please begin your testimony.

**STATEMENT OF DAVID C. QUAM, DIRECTOR OF FEDERAL RELATIONS, NATIONAL GOVERNORS ASSOCIATION**

Mr. QUAM. Gentlewoman Sánchez, Congressman Cannon, Ms. Lofgren, thank you very much for having us back to talk again on this important issue.

I hate to upset the apple cart that has been by the other witnesses, but it may come as no surprise that the National Governors Association, joined by the National Association of Counties, the Conference of Mayors, the National League of Cities and other State and local government groups oppose a permanent moratorium.

However, the good news: We are maybe not all on the same page, but we are all reading from the same book; and that is that the NGA is calling for a reasonable extension of the current moratorium, which will preserve some of the provisions regarding discriminatory taxation, multiple taxation, and continue the moratorium, but do it in a more reasonable manner.

Since we are focused on legislation, let me talk about principles for legislation that are important to the governors. First, and I mentioned these before, be clear. Definitions matter.

Second, be flexible. A temporary solution is better than permanent confusion.

And do no harm. Congress should continue to grandfather protections to preserve existing States authority and revenues.

These principles are not reflected in the bills that were discussed earlier today, and therefore we oppose making the current moratorium permanent.

A couple of the problems with those bills: First and foremost is the definition. Those bills rely on the existing definition, which is a 1998 definition of the Internet that, frankly, just does not apply to the Internet of 2007. I think everyone would agree that there have been significant changes to what constitutes Internet access; and therefore, governors are calling for a precise definition, because Congress is preempting State and local taxation. And when Congress preempts State authority, particularly with revenues, it should be precise, it should be limited and it should be clear.

Second, those bills upset the balance between Federal authority and State sovereignty that was struck by the original moratorium by making the bill permanent and, of course, ending the grandfather provisions. A better alternative can be found in Senate bill S. 1453, that was introduced by Senators Carper, Alexander, Feinstein, Voinovich and Enzi. That bill alters the definition of Internet access to ensure that it is clear and precise and does not make services unrelated to Internet access tax free. It also honors State authority by continuing the original 1998 grandfather clause and sunsets the moratorium in 4 years.

Now, fortunately, as Meredith said, we have some good news; and that is, since the last time, we met industry and representatives of State and local government have been in discussions. We both are looking for an extension of the moratorium, and frankly, we both have issues with the current definition.

And so, working together, we have an agreement on a definition of Internet access that is much more of a rifle shot than the shotgun approach of the existing bill. Following largely on the Carper-Alexander model of being more precise, the definition is more clear and specific. It says that Internet access is a service that enables a user to connect to the Internet. It would include incidental services like e-mail under the definition of the moratorium. It maintains a lot of the telecommunications language and even clarifies it from the last extension on the moratorium. And it makes it explicit that just because a service uses the Internet does not mean that that service had become part of the moratorium.

This more improved definition, however, does not justify making the moratorium permanent. In fact, keeping the moratorium temporary is vital to continuing to honor State and local sovereignty with regard to this issue. A temporary moratorium allows Congress, who is the only arbiter of this moratorium, to return to the issue and make sure that we have gotten it right.

I wish I could say that we have gotten the definition right, but we have had changes for the last several years every time we reauthorize this bill. The Internet is ever-changing. I thought Congressman Campbell said it well, we don't know what the Internet will look like in 10 years.

Finally, the grandfathers are also critical. It is the principle of "do no harm." States are collecting some taxes. The original grandfather States are collecting upwards of $150 million. But that grandfather clause was also an important safety net for other taxes.

Although there are some exemptions for taxes listed currently in the definition, I do not believe that that list is exhaustive nor protects all the State and local taxes and fees that apply to Internet service providers. That safety net must be preserved on a going-forward basis, and the grandfather clause did that.

We would encourage this Committee to join us in the collaborative effort that we have forged with the definition, but then continue by extending this on a reasonable basis, which means keeping the grandfathers and doing so on a temporary basis so Congress can return to the issue.

Madam Chairwoman, thank you.

Ms. SÁNCHEZ. Thank you, Mr. Quam for your testimony.

[The prepared statement of Mr. Quam follows:]

PREPARED STATEMENT OF DAVID C. QUAM

Chairwoman Śnchez, Ranking Member Cannon, and members of the Subcommittee, thank you for inviting the National Governors Association (NGA) to testify today.

My name is David Quam, and I am the Director of Federal Relations for NGA. I am pleased to be here on behalf of the nation's governors to discuss the organization's perspective on the Internet Tax Freedom Act (the "ITFA)".

The bottom line regarding the ITFA is this: although governors generally oppose federal interference with state authority to develop and manage their revenue systems, NGA supports a temporary extension of the Internet Tax Freedom Act that clarifies the definition of Internet access and does not further limit state authority or revenues.

BACKGROUND

Although the U.S. Constitution grants Congress broad authority to regulate interstate commerce, the federal government, historically, has been reluctant to interfere

with states' ability to raise and regulate their own revenues. State tax sovereignty is a basic tenet of our federalist system and is fundamental to the inherent political independence and viability of states. For this reason governors generally oppose any federal legislation that would interfere with states' sovereign ability to craft and manage their own revenue systems.

The 1998 Internet Tax Freedom Act, which imposed a moratorium on state or local taxation of Internet access, is one exception to longstanding congressional forbearance when it comes to state tax issues. Designed to help stimulate this new technology by making access to the Internet tax free, the moratorium included three important restrictions to protect states:

1. The moratorium applied only to new taxes—existing taxes on Internet access were grandfathered;
2. The definition of "Internet access," while broad, excluded telecommunications services; and
3. The moratorium expired after two years to allow Congress, states and industry the opportunity to make adjustments for rapidly developing technologies and markets.

In 2000 the original moratorium expired, but was extended through November 1, 2003, with its protections for states still in place. In 2003, and 2004, Congress debated bills that targeted state protections by proposing to eliminate the grandfather provision, modify the telecommunications exclusion to address tax disparities between telecommunications broadband services and those of the cable industry, and make the moratorium permanent. Fortunately, the final bill retained several of the original state protections including the grandfather clause, an exception for taxes on voice-over-internet-protocol (VOIP) services, and an expiration date of November 1, 2007.

As Congress begins to consider changes to the ITFA, governors recommend that members examine the scope of the moratorium in light of technological advancements; update the ITFA's definitions to ensure they reflect congressional intent and do not unnecessarily interfere with state taxing authority; extend the moratorium on a temporary basis to respect state sovereignty and the ever-changing nature of the Internet; and retain the original grandfather clause to preserve existing state and local tax revenues.

CONGRESS SHOULD CLARIFY THE DEFINITION OF "INTERNET ACCESS"

A core concern for states is the potential breadth of the ITFA's definition of "Internet access." The current definition of Internet access states:

> "Internet access means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, **and may also include access to proprietary content, information, and other services as part of a package of services offered to users.** Such term does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access." *(Emphasis added)*

The first sentence of the definition has not changed since 1998 and allows a provider of Internet access to bundle "proprietary content, information, and other services" together with access to make the entire offering tax free. NGA believes that the unlimited ability of providers to bundle together content and "other services" into a single, tax-free offering represents a loophole that could have the unintended effect of exempting content, information or services from otherwise applicable taxes merely because they are delivered over the Internet.

The risk of states losing significant revenues from this provision has grown significantly as broadband connections have become more common and companies have altered business plans to deliver more services over the Internet. Since 2001, the number of high speed lines in the United States has risen from more than 9 million to nearly 65 million with high-speed connections in the United States growing by 52 percent in 2006 alone.[1] Governors support the deployment of broadband services because they increase the ability of citizens to utilize the vast array of services and information available online and are critical to our nation's economic growth and competitiveness.

As more consumers move online, Internet protocol technology is also making more services available over the Internet. For example, a key issue of the 2004 ITFA de-

[1] Response of Kevin J. Martin, Chairman, Federal Communications Commission, to pre-hearing questions asked by the House Committee on Energy and Commerce, February 7, 2007.

bate centered on whether VOIP would become a viable alternative to traditional phone service. Unlike traditional telecommunications services, VOIP uses the Internet to transmit voice communications between computers, phones and other communications devices. Today, analysts project that VOIP subscriptions will top 18 million in 2009, a dramatic rise from VOIP's 150,000 customers in 2003.[2] The concern in 2004 was what would happen to the $23 billion state and local tax base for telecommunications services if VOIP replaces telecommunications services and were allowed to be bundled with Internet access into a tax-free offering. Congress' solution during the last ITFA extension was to specifically exempt VOIP from the moratorium. This solution, however, did not solve the problem of the underlying definition.

The next major service moving to the Internet is video programming. Known as Internet-protocol television (IPTV), this service represents another technological leap for industry and challenge for the ITFA. Worldwide, the annual growth rate of IPTV is projected to exceed 92 percent, rising from 3.9 million subscribers in 2006 to 103 million in 2011. The service brings together voice, Internet and entertainment services in a bundle marketed by some as a triple-play.[3] Much like VOIP in 2004, if a service like IPTV is packaged with Internet access and exempted from applicable taxes, it would create tax disparities for competitors offering similar services and undermine existing state and local revenues.

The emergence of services such as VOIP and IPTV underscore the need to clarify the definition of what constitutes "Internet access" so that the taxability of a good or service is not determined by whether it can be bundled with Internet access and delivered over the Internet. Although NGA supports having the moratorium apply to services related to providing access to the Internet such as email, Congress should close the bundling loophole by specifying that the definition of "Internet access" applies only to those services necessary to connect a user to the Internet.

ANY EXTENSION SHOULD BE TEMPORARY

When the ITFA became law in 1998, it was passed as a temporary measure to assist and nurture the Internet in its commercial infancy. The Internet of 2007 is far different. It is a mainstream medium that has spawned innovation, created new industries and improved services. What started as primarily a dial-up service available through a handful of providers, today is available through thousands of internet service providers using technologies ranging from high-speed broadband cable or Digital Subscriber Line services, to wireless, satellite and even broadband Internet access over power lines.

Commercial transactions over the Internet have also exploded. A recent study by the National Retail Federation concluded that Internet sales grew from $176 billion in 2005 to $220 billion in 2006, a 25 percent jump that outpaced projections.[4] The survey projects online sales for 2007 will jump 18 percent to $259 billion. According to one of the survey's senior analysts, "[t]his strong growth is an indicator that online retail is years away from reaching a point of saturation."[5]

The rapid pace of innovation in the Internet and telecommunications industries makes it difficult to define accurately these complex and ever-changing services. Congress made the original moratorium temporary in part for this reason: to provide Congress, industry and state and local governments with the ability to revisit 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 temporary extension of the moratorium remains the best way for Congress to avoid any unintended consequences that may arise from a permanent moratorium.

Another reason to support a temporary extension is that making the moratorium permanent would establish a troubling precedent that distorts the state-federal relationship. As mentioned previously, governors generally oppose federal efforts to interfere with state revenue systems because such interference undermines a states sovereign authority to provide government services. A more immediate consequence of a permanent ban on state taxes is the increased pressure Congress would receive from other industries seeking similar preemptions of state laws. Legislation to impose a moratorium on state and local cell phone taxes and efforts to dictate state nexus standards for business activity taxes are recent examples of the types of pre-

[2] Telecommunications Industry Association's 2006 Telecommunications Market Review and Forecast, February 27, 2006.

[3] Harris, Jan, "IPTV subscription to grow 92% year on year," Platinax Small Business News, April 10, 2007.

[4] *The State of Retailing Online 2007,* Shop.com/Forrester Research Study, May 14, 2007.

[5] *Online Clothing Sales Surpass Computers, According to Shop.org/Forrester Research Study, viewed at* www.nrf.com (May 17, 2007).

emptions strongly opposed by state and local governments that would be bolstered by passage of a permanent moratorium.

CONGRESS SHOULD MAINTAIN THE MORATORIUM'S "GRANDFATHER" CLAUSE

NGA recommends that any extension of the moratorium preserve existing state and local revenues by continuing the so-called grandfather clause for taxes imposed prior to 1998. The grandfather clause serves two purposes; first, as a protection for existing state and local tax revenue; and second, as a means to preserve other state and local taxes not specifically mentioned by the ITFA.

Today only nine states have direct taxes on Internet access that qualify for the protection of the 1998 grandfather clause. Those states include Hawaii, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Texas, Washington and Wisconsin. According to Congressional Budget Office estimates from the 2004 ITFA extension, eliminating the grandfather clause will cost those states between $80 million and $120 million annually. While these amounts may seem insignificant in terms of federal dollars, balanced budget requirements at the state level require that any unanticipated loss of revenues must be made up by either cutting services or raising revenues. These losses also are high enough to make the elimination of the grandfather clause an unfunded federal mandate under the Unfunded Mandate Reform Act. Any extension of the moratorium should therefore preserve the grandfather clause so as not to reduce existing state and local tax revenues.

The grandfather clause also serves as an important protection for all state and local taxes that indirectly affect providers of Internet access. Under the ITFA, a "tax on Internet access" means:

> [A] tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax."

Because a tax on Internet access includes both taxes on users and Internet access service providers, some experts interpret the moratorium as applying to both direct taxes on Internet access and indirect taxes such as business taxes on a provider of Internet access. In fact, the pre-1998 versions of the moratorium expressly excluded certain indirect taxes such as income and property taxes from the moratorium. That language was later dropped because the grandfather clause applies to all taxes on Internet access in force before October 1, 1998.[6] Although the 2004 extension does preserve the ability of states to impose a tax "levied upon or measured by net income, capitol stock, net worth, or property value," this list is not exhaustive. Preservation of the grandfather clause is important because it allows Congress to avoid having to define those direct taxes subject to the moratorium and any other taxes that lie outside the scope of the moratorium.

*S. 1453, the ITFA Extension Act of 2007*

Contrary to H.R. 743, the Permanent Internet Tax Freedom Act of 2007, or H.R. 1077, the Internet Consumer Protection Act of 2007—bills that would make the existing moratorium permanent—S. 1453, a bipartisan bill introduced by Senators Carper, Alexander, Feinstein, Voinovich and Enzi, best reflects the principles for reform set forth above.

First, S. 1453 maintains the balance between federal authority and state sovereignty by preserving the original grandfather clause and extending the moratorium for four years.

Second, the bill specifically defines "Internet access" as a service that "enables users to connect to the Internet." The bill includes in its definition of access incidental services such as electronic mail or instant messaging. It also recognizes the change to the treatment of telecommunications used to provide Internet access that was part of the last extension. Finally, it makes it clear that just because a service can be provided over the Internet does not mean that the service becomes part of the moratorium. The definition in S. 1453 is specific and clear and cures many of the problems that exist with the current ITFA definition of Internet access.

CONCLUSION

Governors remain steadfast in their insistence that decisions regarding state and local taxation should remain with state and local officials. The independent and sov-

[6] Mazerov, Michael, "Making the Internet Tax Freedom Act permanent in the form currently proposed would lead to a substantial revenue loss for states and localities," Center on Budget and Policy Priorities, October, 20, 2003.

ereign authority of states to develop their own revenue systems is a basic tenet of self government and our federal system.

NGA has been working collaboratively with industry to address state and industry concerns with the ITFA. Those talks have helped state government and industry representatives more specifically define what should constitute Internet access in 2007. Like the definition in S. 1453, the new definition is more specific and clear and addresses the uncertainties raised by both industry and states. This improved definition, however, does not justify making the ITFA permanent. Instead, Congress should continue to honor state sovereignty by building upon government and industry's collaborative efforts, incorporate the new definition of Internet access into a temporary extension of the moratorium, and preserve the original grandfather clause.

Ms. SÁNCHEZ. We will now begin a round of questioning, and I will begin by recognizing myself for the first 5 minutes.

Mr. Quam, what effect would either H.R. 743, the "Permanent Internet Tax Freedom Act of 2007," or H.R. 1077, the "Internet Consumer Protection Act of 2007," the two bills that were discussed in the previous panel, have on State and local revenues if either of those were passed?

Mr. QUAM. If either of those are passed, the concern is that on an ongoing forward basis, there is a lot of risk placed on States. The current definition and the definition that would be used under either bill would include the ability to package other services with Internet access and make the entire package tax free.

This was the key issue back in 2004 when this bill was last authorized; and during that time the question was, what would happen to voiceover Internet services? VOIP ultimately was specifically exempted out of fear that all telecommunications taxes could be lost under that broad definition.

Because that definition has not been fixed, Congress has a choice. It can keep it and continue to exempt just whatever the next technology that is going to move over the Internet is, or it can precisely define what the Internet access is and limit the scope of this too-early Internet access.

The fear ultimately would be, the next VOIP may be Internet protocol television. And that is a lot of the, say, franchise fees are earned under cable. As television moves to an Internet protocol, if that was bundled up with Internet access, it would make the entire thing tax free. Under a permanent bill, that is much more likely.

Ms. SÁNCHEZ. Okay. And if Congress decided to eliminate the grandfather protection for those States that had already imposed Internet access taxes, as of 1998, what would be your suggestion as to the best way to minimize the effect on State and local government revenues?

Mr. QUAM. I am not sure I like the premise of the question, but for the Chairwoman, I will go with it.

Ms. SÁNCHEZ. Assume a hypothetical.

Mr. QUAM. Fair enough.

The most important thing is to recognize the safety—in your hypothetical is to recognize the safety net that the grandfather clause put in place. When this was originally drafted in 1998, there had been a provision to try to list all the different taxes that should not be part of the moratorium. Ultimately, that was taken out of the 1998 bill, what became the 1998 law, because you had the safety net of the grandfather clause protecting all those taxes, so it was redundant.

If the grandfather goes away, that safety net is important. Unless Congress believes that all taxes should fall under this moratorium with regard to providers of Internet access—and, again, the definition of tax is quite broad; there are a few exceptions—then a safety net has to be there so that Congress tells States and, frankly, companies exactly what it means—what taxes can be applied, what taxes cannot be applied even to a business that is offering Internet access.

Ms. SÁNCHEZ. Okay.

Ms. Garwood, State advocates whom we heard from have indicated that the loss of the grandfather protection would cause about $150 million revenue loss and that this loss would affect local government's ability to hire, for example, more police officers and fire fighters, pay for road improvements and fund other community projects.

How do you respond to those legitimate concerns of State and local governments?

Ms. GARWOOD. Congress adopted a national policy in 1998, and we are a decade later, and States have known that this is an issue. If the grandfather continues, then we allow disparity between consumers from one State to another; and the consumers that are in the States that have been grandfathered have not had the benefit of Internet access without tax on it. It is now the time and there has been a lot of warning coming forth that these grandfathers would need to go away.

On the point that David raised about the definition of tax, we disagree on the impact of the grandfather being eliminated on that. The definition of tax was an issue for 2004. There was a lot of work put around it to get a clear definition, and I think the logic doesn't hold true in that many States have put in new taxes since 1998 not related to Internet, and this definition of taxes have not protected that.

So we think there is a clear definition of tax on Internet access, and we think the removal of the grandfathers does not create an issue. We can't allow the definition of tax to be manipulated in a way that it will undermine the intent of the moratorium. So we have those concerns.

Ms. SÁNCHEZ. Thank you.

My time has expired, so I would invite Mr. Cannon for 5 minutes of questions.

Mr. CANNON. Thank you.

Ms. Garwood, When Mr. Quam was talking about negotiations, you were nodding; and that didn't get in the record. You nodded again. Would you mind just saying—let me just ask the question. You are discussing these issues, industry is discussing these issues, and we have advanced in actually redacting something that will work.

Ms. GARWOOD. Yes, we do have an agreed-upon definition between FTA, NGA and the Coalition. It addresses the concerns of the Coalition related to the taxation of the backbone of the Internet. And while we believe the 2004 bundling language that was put in addressed the States' concerns, we did agree to work with the States to further define Internet access in a way where they are comfortable, the Coalition is comfortable, and we have language.

Mr. CANNON. This is an extraordinarily complex process.

I note that Mr. Watt was here earlier, and we worked very closely together on many of these issues last time around, and I think for a long time we actually had hopes that we would be clear on VOIP. But that came to a dramatic stop or halt in the other body.

So, recognizing the complexity, we are working together with you on that, my staff and the Committee staff and the Chair staff; and we are hopeful that we can get a bill that will actually advance the clarity on this issue so that we can move forward.

Mr. Quam, I would like to ask you a question. Thank you for being back. We appreciate your involvement and work and perspicacity on this issue.

But one of the things that I think is amazing is that we have got State and local revenues going through the stratosphere here recently. That in significant part is due to e-commerce and the new economy largely driven by the Internet but also by technological advances of computers. You would agree with that——

Mr. QUAM. The Internet has certainly been a boom to the economy, no question.

Mr. CANNON. I had this discussion with the bricks and mortar guys and how they are doing better and how the fact that the Internet works is driving that to some degree.

For purposes of taxation, we do have now some distance and some perspective that we didn't have in the past. Over the last 10 years, L.L. Bean, for instance, which was a catalog company at one point—I don't know. I haven't looked at the statistics. They are all over Utah. My guess is they are a national company, and there are virtually no States that can tax them because they already have nexus.

What I would like from you here is a little perspective on what the States ought to be doing to encourage the kind of growth that happens because you get a multi-channel distribution and therefore the ability to tax and why that is good for the economy and then why we ought to be careful as we think about what we tax on the Internet. Do you have thoughts? I know you have thoughts. Would you mind sharing them with us on that?

Mr. QUAM. Thank you, Congressman. You are right. These are very complex issues.

As you well know, here we are talking about tax of Internet access, and too often that does get confused with other transactions over the Internet. The sales tax issue—I am sure if Mr. Delahunt was here, he would speak about the streamlined sales tax initiative and how that is a proactive way in which States have tried to address that national issue to really minimize the difference between bricks and mortar and Internet stores. You do talk about a recent phenomenon just in the last 5 years of what we call bricks and clicks, where all of a sudden bricks and mortar stores are going on line and where you might order on line but then you go to the store to pick it up, maybe you go to the store to get it serviced. And that largely has been read to create the type of nexus where sales tax can be collected.

Mr. CANNON. May I interrupt your thoughts to direct it particularly? What we are talking about here is access to the Internet, and that is the most foundational tax and, therefore, it seems to me the

tax we need to be most careful about constraining. And in particular that is what I would like your thoughts on.

Mr. QUAM. Again, we have come up with an extension of the moratorium. So those protections will remain in place.

With regard to the Internet itself—and I think we talked about this a little bit in May—there is a couple of studies that said that tax on Internet—and we happen to have a laboratory here since we have nine States who kept it. But the GAO and a study out of the University of Tennessee said those taxes had no bearing on broadband penetration. And as a matter of fact, the recently report out of the Center on Budget and Policy Priorities listed the tax rates for all those countries ahead of the United States.

Mr. CANNON. My time has expired. Madame Chair, may I ask unanimous consent just to refine the question?

Ms. SÁNCHEZ. Without objection.

Mr. CANNON. The issue is not so much broadband penetration. We have sort of been over that and the effect. It is the chilling of the larger environment that I would like you to respond to. In other words, the fact that we have grandfathers, the fact that we don't have a permanent Internet moratorium in some way—it obviously chills.

I don't think there are any quantitative studies out there that deal with this, but one looks at the economy that is booming and says, what are the little impediments out there? You can't identify their total effect. But is there an effect by these little impediments like a grandfather or like the fact that it is not permanent?

Mr. QUAM. I think those studies show for those grandfather States this has not been an impediment to people getting on the Internet.

Mr. CANNON. You are right in the answer, and what you said is correct, but I don't think that is responsive to the question. But I see my time has expired and will yield back, Madame Chair.

Ms. SÁNCHEZ. Thank you, Mr. Cannon.

At this time, I would like to recognize the congresswoman from California, Ms. Lofgren, for 5 minutes of questions.

Ms. LOFGREN. Thank you, Madame Chairwoman.

I don't have probably 5 minutes of questions, but I do want to make sure that whatever discussions have occurred between the various interested parties, make it very clear that the Internet backbone is not subject to taxation. I mean, I think it ought to be much broader than that personally, but that would be a disaster.

Do both of you feel confident that we are going to avoid the taxation of the backbone in whatever language you guys are looking at?

Ms. GARWOOD. We have language that does that. It is a very strong point that we had, because we do have States from the 2004 amendments that have taken aggressive positions that they continue to tax the Internet backbone. We think it is important to once again make it very clear that that cannot continue, and the language that we have we think accomplishes that.

Ms. LOFGREN. I do agree. That is good news.

I can recall, as I mentioned to our first panel of witnesses, being in local government; and it is oftentimes a tough position, especially in California. You really don't have an ability to do—I mean,

since Prop. 13, property taxes are simply—you could have a hundred percent vote of your electorate and you can't do anything.

So I do understand there is a revenue need and there are important services. But it is easy to feel the pressure of needing to raise the funds for essential services and to lose sight of the broader economic value of the Internet in telecommunications, because I really believe that the prosperity that has lifted up our Nation is so much related to the development of technology, and our future, really, our prosperity is going to be tied to that as well.

So I think, to make sure that this is not tempting to States and localities, it is an obligation that we have to preserve our opportunity to develop our high-tech sector; and I hope that we can have the broadest definition and a permanent moratorium. I think that would be the best service we could do for all our States, all our counties and cities and for the economic future of the country.

So I thank the Chairwoman.

Ms. SÁNCHEZ. Thank you, Ms. Lofgren.

At this time, I would like to recognize the gentleman from Tennessee, Mr. Cohen.

Mr. COHEN. Thank you, Madame Chair.

First, I have got a question; and I am not sure if I should address it to the lady from Time Warner or to our friend from the Governors Association. But is there any Federal law on taxation of cable television services or is that strictly up to the States?

Ms. GARWOOD. The States.

Mr. COHEN. Strictly?

Ms. GARWOOD. Uh-huh.

Mr. COHEN. Let me ask you this. I am a sponsor of the bill that says there should be a permanent moratorium. I agree with Congresswoman Lofgren. I think that access to communications and speech should not be taxed, and I just wonder why—and it would probably be difficult politically—but why the Federal Government hasn't had some limitation on the State and localities' ability to tax cable television, at least to the basic service rate.

Has that, to the best of your knowledge, never come up? What do you think about that? What is the difference in the Internet and cable TV basic service as far as the right of people to be able to get ideas and to have access to certain news and information?

Ms. GARWOOD. I would agree with your theory, and I would say that some States do not tax basic service cable for that reason. And it has been a State decision. It has not been something that has been federally preempted at this time.

Mr. COHEN. And I know that Mr. Quam—is there any tax at all that the Governors don't like?

Mr. QUAM. Congressman, raising taxes is just as difficult on Governors as it is on Congressmen. So I would disagree with your assessment that somehow Governors like all taxes.

I think the key part here is that State and local revenue systems need to be designed and operated by State and local officials, not by the Federal Government.

Mr. COHEN. I understand and appreciate that position; and many times I am a States' rights person, thinking you get better response on a local level. But I was a State senator for 24 years. I was a progressive one, however. Most Governors and legislators like the

most regressive tax because it is the easiest thing, is to tax the people—don't tax me, don't tax me, tax that guy behind that tree. That is their philosophy.

So if the Federal Government can put some progressivity into the tax structure and say we think the people should have an access to information, which the Internet—it is the worldwide Internet. It is not New Mexico's or Tennessee's or Los Angeles's. It is the worldwide Internet. I would think we ought to go further and look at prohibiting the States and localities from taxing basic cable.

We didn't tax when you plugged in your TV and you watched Chet and David. We didn't tax that. But now you have got it coming through the cable, and the States benefit in a regressive way so that the people in the lower income levels have to pay, you know, this regressive tax. It doesn't seem fair, does it, Mr. Quam?

Mr. QUAM. That authority has got to remain with the State and local officials. If the citizens don't like the tax that is applied by State and local officials, then there are elections for that.

I have had Governors say before the most important thing in them running their States is really for the Federal Government, especially in revenue systems, to stay out of the way and they can do the right thing. The characterization may be accurate from your experience. However, I think a lot of Governors would disagree in that State and local officials really are interested in doing the right thing.

In the hearing before, Congressman Cannon, we talked about, last year, what is the most important thing that States could do or that the Federal Government could do with regard to communications taxes in general. My answer at that time is the same as it is today, and it is don't impede the State's ability to modernize their own tax systems.

If Congress steps in and interferes, that actually hinders the ability of State and local governments to make other choices and to modernize some of the tax systems that are old.

Mr. COHEN. But if you were progressive, as I am, and you had a ban on basic cable television service, that would force the Governors and the legislators—and many of them are wonderful people and good progressives and even good nonprogressives, regressives, so to speak—that they would then be forced to have a more humane and progressive tax system because this easy one would be taken away from them.

Mr. QUAM. I think you would also have a very serious problem, especially at the local level, where a lot of those taxes—and this goes to the principle of do no harm. When Congress acts under the commerce clause authority, there are real consequences at the State and local level, in particular because cable franchise fees are a more local issue than anything else. But that is starting to change in some States.

You are talking a significant tax base that goes to fund some of the basic services of government. So running those governments into a cliff and saying, well, we are going to take that one away from you actually hurts the basic services of government. That is why those decisions must remain at the State and local level.

Ms. SÁNCHEZ. The time for the gentleman has expired.

Mr. COHEN. As I have learned, when the time expires I yield back the remainder of my time.

Ms. SÁNCHEZ. And, of course, we have saved the best for last. I would at this time like to recognize the gentleman and all-around wonderful colleague from Massachusetts, Mr. Delahunt, who has been patiently waiting to be recognized for his questioning.

Mr. DELAHUNT. Well, thank you so much for your kind observations, inaccurate as they may be.

Mr. CANNON. The minority endorses that recommendation, by the way.

Mr. DELAHUNT. Well, if I can take those words and use them sometime in a different form, I will remember them.

We have been dealing with these issues now for an extended period of time; and I tend to agree in principle with my dear friend and colleague to my left, Congresswoman Lofgren. But the reality is we have a significant problem.

And I heard your testimony. I was watching you, Ms. Garwood, on TV; and you really didn't respond to a previous question about what do we do about the loss of revenue for the States. I mean, it really presents an incredibly serious problem. Because what we do when we support the moratorium, whether it be permanent or temporary, whether it eliminates the grandfathered taxes, you know, on the States that currently have them, we have to address it. I think it is a responsibility by this Congress if we are going to limit the options of the individual States.

My proposal has been the adoption of the SST, the streamlined sales tax issue; and I am pleased to note that the Chair of this particular Subcommittee has indicated that she will hold a hearing on that issue. And there is a nexus between those two.

Let me pose a question to Mr. Quam. I think your testimony was that the loss of revenue to the States, if the grandfathered taxes were eliminated, would be in the neighborhood of $150 million. Is that accurate?

Mr. QUAM. Yes, for the original grandfather States, yes.

Mr. DELAHUNT. Yet, in 2008, it is estimated by the Center for Business and Economic Research located at the University of Tennessee that the loss of revenue in terms of the sales tax in 2008 would be somewhere between $22 billion and $34 billion. I mean, in the sense of proportionality, the States have a much more significant interest in resolving that particular issue. Is that a fair statement?

Mr. QUAM. It is.

Mr. DELAHUNT. I mean, it is clear and obvious. And while I don't think there is anybody that doesn't support e-commerce and it is the wave of the future, I also have a concern about mom and pop, those small businesses that for whatever reason don't have the resources or the infrastructure, the capital, the talent and the expertise to sell their products and services on line. They are at a competitive disadvantage.

And it is more than just dollars and cents, from my perspective. I mean, many of those small businesses really are an integral part of the fabric of a community.

You know, I always use the example of the independent drugstore where you could, you know, go in when you were a child com-

ing home from school and the proprietor would be the sponsor of your little league team and knew your family. You don't do that at CVS.

So there are a lot of issues here. How do we make up for that lost revenue? Ms. Garwood? Yeah, go.

Ms. GARWOOD. My position would be that there is no evidence of States that don't tax Internet access struggle with revenue to pay for schools and roads.

Mr. DELAHUNT. Let us understand that we are just a bit off that right now. We are talking about the collection of the sales tax through e-commerce. How do we make up the $22 billion or the $33 billion? Do we just ignore it and pretend? Do we just continue to focus in on the—I am with you. I am with you on the moratorium. I am with you on this. What do we do? Tell us what we do to make up the revenue loss.

Ms. GARWOOD. Well, I would say our Coalition has a varied group of companies, some supportive of streamline, some not. And our position is that, while we understand what you are——

Mr. DELAHUNT. What you are telling me is that you don't have any sense of—the Coalition that you represent—I am not saying they don't care——

Ms. GARWOOD. It is not that we don't care.

Mr. DELAHUNT. But they don't care.

Ms. GARWOOD. With the Internet tax moratorium, we have a deadline. We have November 1, 2007, upon us quickly. And we think this bill, the Internet Tax Freedom Act bill, it is very important for it to be a clean bill and that attaching streamline or other kinds of——

Mr. DELAHUNT. And we can handle that sometime in the future.

Ms. GARWOOD. Well, I am just saying I don't think we will meet the deadline of moving this forward if we attach other issues to the Internet tax moratorium.

Mr. DELAHUNT. How would you make up the loss of revenue as far as the loss of sales tax revenue?

Ms. SÁNCHEZ. The time of the gentleman has expired.

Mr. DELAHUNT. Can I ask for unanimous for another minute?

Ms. SÁNCHEZ. Without objection.

Ms. GARWOOD. I don't have a solution to your problem. I can't——

Mr. DELAHUNT. See, it isn't my problem. That is the point that I am making.

Ms. GARWOOD. The point you are making——

Mr. DELAHUNT. The problem is it is the local communities that will have to raise the property tax in Massachusetts, for example, or in Florida. These are States with a significant portion of their revenue from sales tax. It is all of our problem.

I mean, I understand you are here, you are paid by the Coalition, and you are doing an excellent job representing their position. But I think we make a mistake not to examine the context and to understand our collective responsibility to assist the States and local governments in meeting this shortfall. Otherwise, we are going to have layoffs, and it is going to be everybody's problem. Because our children will suffer as a result of layoffs of teachers and police and

fire and all of those services that directly impact the citizens that we all represent.

Ms. SÁNCHEZ. The time of the gentleman has once again expired.

Mr. CANNON. Madame Chair, I would like to ask unanimous consent to include in the record that *Wall Street Journal*—I think this is an online article—dated June 11, 2007, which points out that State tax collections were $1.1 trillion in 2005, 8½% higher than in 2004.

I think the resolution of the gentleman's problem is increased revenues, not grasping at every source, but helping—and this is where Mr. Quam and I have disagreed with great regularity; and I think I have been proven right despite the particular studies.

We have a remarkable economy. We ought not kill the golden goose. At least at the minimum what we need to do is make sure we don't——

Mr. DELAHUNT. Would my friend yield?

Ms. SÁNCHEZ. The gentleman has asked unanimous consent to enter something into the record. Without objection, the article will be entered into the record.

[The information referred to follows:]

THE WALL STREET JOURNAL.

REVIEW &OUTLOOK (Editorial)
**Flush States**
288 words
11 June 2007
The Wall Street Journal
A12
English
(Copyright (c) 2007, Dow Jones & Company, Inc.)

The Census Bureau has released data on state and local finances for the 2005 fiscal year, and here are a few findings that tax-happy politicos might prefer to keep under wraps.

Total state and local tax collections were $1.1 trillion in 2005, or 8.5% higher than 2004 and 2.5 times the rate of inflation. Lucky New York led the way with a per capita state and local tax burden of $5,770, or 56% above the national average and 7% above second-place Connecticut. Governor Eliot Spitzer will help New York hold its top spot with his 6.3% increase in spending.

Nationwide, personal income tax collections rose 12% in 2005, and sales and property levies were up 6.3% and 5.5%, respectively. The problem, as usual, has been on the spending side. State and local expenditures overall rose by 4.7%, with health care and education outlays accounting for much of the increase.

Robert Ward, the Rockefeller Institute's director of fiscal studies, says states can't use the common excuse that more spending was necessary to make up for federal cuts and "mandates" like No Child Left Behind. "Federal domestic spending has been relatively constant in the last few years, as a share of GDP," says Mr. Ward. "In other words, the most recent increase in state and local spending is not offsetting net cuts at the federal level."

These columns have reported on the record receipts to the federal Treasury in the wake of the Bush tax cut, and the states have done nearly as well. If state budgets aren't balanced, don't blame taxpayers.

Ms. SÁNCHEZ. Does Mr. Delahunt seek unanimous consent?

Mr. DELAHUNT. I seek unanimous consent for just an additional minute to respond.

I want the economy to improve. I am glad when I see the revenues increase so that we can afford better schools, better

healthcare, et cetera, et cetera. But we have had a pretty good run, and I understand that right now the States and local governments in some cases are doing well and in other cases aren't doing so well, depending on what part of the country and what economic group is represented in particular communities.

But let me tell you, when the economy starts to tank and—turn on the news today. The market is down again, and we are going to have real serious issues. And if you are in favor of raising property taxes, then don't do anything in terms of the collection of sales taxes. That, in my opinion, will be the most logical outcome.

Ms. SÁNCHEZ. The time of the gentleman has expired.

I think, Mr. Cannon, we have some work to do in terms of working out a workable solution, but I am hopeful that that can happen.

I want to thank the witnesses for their testimony today.

Without objection, Members will have 5 legislative days to submit any additional written questions which we will forward to the witnesses and ask that you answer as promptly as you can to be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any additional materials.

Again, I want to thank the witnesses and everybody on the Subcommittee for their time and patience; And this hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 11:34 a.m., the Subcommittee was adjourned.]

# APPENDIX

---

## Material Submitted for the Hearing Record

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, TO MEREDITH GARWOOD, VICE PRESIDENT, TAX POLICY, TIME WARNER CABLE

RESPONSES TO WRITTEN QUESTIONS FOR MEREDITH GARWOOD

1. Your coalition supports a permanent moratorium. Please explain why Congress should not simply impose a temporary moratorium and revisit the issues that are certain to arise during the next few years such as with the definition of "Internet access."

ANSWER - Time will not change the fact that internet access taxes unfairly discriminate against electronic commerce and raise the cost of internet access for American consumers. It goes without saying that Congress is free to address issues related to the internet tax moratorium at any time – there is no need to wait for the expiration of a temporary extension. With respect to the definition of "internet access," the Don't Tax Our Web Coalition has worked with the Federation of Tax Administrators, the National Governors Association and others to agree on a new definition of internet access that clearly defines the scope of the moratorium.

2. In your written testimony for today's hearing, you state that your "coalition has been working collaboratively with" state and local government representatives "in an effort to make unmistakably clear that the internet 'backbone' and the other components of Internet transport are covered by the moratorium." Does not the current definition of "Internet access" address this concern?

ANSWER – The members of the Don't Tax Our Web Coalition believe that the current definition of internet access preempts state and local taxes on "backbone" and other components of internet transport. However, some state and local taxing authorities believe that the existing definition does not cover wholesale transactions and have attempted to impose taxes on this form of Internet access. The revised definition clarifies Congress' original intent, as reflected in the debates on the previous extension of the moratorium, that backbone, wholesale or other transactions to buy or purchase internet access are protected from tax.

3. Does the new definition address all of the concerns state and local governments have of the potential for industry to bundle products with Internet access?

ANSWER – The new definition negotiated by the Don't Tax Our Web Coalition and the NGA and FTA addresses concerns raised by both sides. Both sides support the proposed definition.

4. During the hearing, the Chair asked you the following question:

> State advocates have indicated that the loss of grandfather protection would cause around a $150 million revenue loss and that this loss would affect their ability to hire more police officers and firefighters, pay for

road improvements, and fund other community projects. How do you respond to their legitimate concerns?

However, you did not answer the question. Please respond to the concerns of the state advocates.

ANSWER - Most states currently enjoy significant budget surpluses. In June of this year the Census Bureau reported on 2005 data for state and local government finances. That report showed that personal income tax collections increased 12%, sales taxes rose 6.3%, and property taxes were up 5.5%. A permanent moratorium on internet access taxes will benefit consumers, encourage broadband investment, and continue to spur e-commerce. It would have a negligible impact, if any, on the services provided by state and local governments.

5. What evidence do you have that eliminating the moratorium would have an appreciable effect on the growth of electronic commerce? On the deployment of the internet? On the advancement of technology?

ANSWER - During the last 9 years in which the internet tax moratorium has been in place, internet commerce has grown dramatically. According to the Census Bureau, the value of e-commerce in 2005 was $2.4 trillion, a more than 8% increase over 2004. Taxing internet access would raise the cost of electronic commerce compared to traditional methods of commerce. Much recent attention has been paid to the United States' broadband deployment rate compared to other countries. Raising the cost of internet access by increasing existing taxes or imposing new taxes will discourage broadband uptake rates. It follows that reducing consumer demand for broadband services (by raising the cost of those services) will lower the investment in new broadband technologies.

RESPONSES TO POST-HEARING QUESTIONS SUBMITTED BY THE HONORABLE LINDA T. SÁNCHEZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRWOMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, TO DAVID C. QUAM, DIRECTOR OF FEDERAL RELATIONS, NATIONAL GOVERNORS ASSOCIATION

**Responses by David C. Quam to House Subcommittee on Commercial and Administrative Law Additional Questions**

1. In your written testimony for today's hearing, you state that state government and industry have worked together to "more specifically define what should constitute Internet access in 2007." Please explain the collaborative efforts in creating the definition. Does the new definition address the concerns of state and local governments? And also please explain shy the new definition benefits state and local governments.

   Following the Subcommittee's May hearing, NGA and the Federation of Tax Administrators invited members of the telecommunications industry to work with us on a new definition of Internet access. That effort led to a definition that more closely resembles that of S. 1453 introduced in the Senate. Specifically, the definition eliminates the ability to bundle any service with Internet access and make the entire service tax free. It specifies that only a service that "connects" a user to the Internet; telecommunications purchased used or sold to facilitate that connection; and services incidental to the connection such as email are subject to the moratorium. The definition also specifically states that other goods and services that use the Internet such as voice, video or audio services are NOT part of the moratorium. This exclusion from the moratorium includes services such as voice-over-internet-protocol services and internet-protocol television services or any other product or service that is delivered or uses the Internet.

2. Considering the joint effort of industry and state and local governments in creating a new definition of "Internet access," could Congress consider it the final definition and no longer have to address the issues related to it in the future?

   If the new definition is adopted, it will be the second time in a row that the definition of Internet access has undergone major revisions at the request of both industry and state and local governments. Given the considerable change that has occurred just in the last four years since the last extension of the ITFA, it would be presumptuous to assume that this definition is adequate to address all issues for government or industry into the future. The moratorium should be temporary to allow Congress to revisit the moratorium and make adjustments for any unintended consequences.

3. In your written testimony for today's hearing, you encourage Congress to impose a temporary moratorium instead of a permanent moratorium. How long of temporary moratorium would benefit not only state and local governments, but also the industries related to the Internet? Should we consider a short moratorium, such as a 2-year moratorium? Or much longer, such as a 12-year moratorium?

   The last extension of the moratorium was the longest on record at four years. NGA supports a four year extension in the Senate (S. 1453.). Anything longer would

exacerbate the risk to states of any unintended consequences that arise from changes in technology or the Internet industry.

4. If Congress decided to eliminate grandfather protection for those states and local governments that had already imposed Internet access taxes as of 1998, how many years minimum would those states need to prepare for the elimination of the grandfather protection?
   NGA does not support eliminating the grandfather provision. States should not be required to drop an existing revenue stream that they have relied on since 1998. Furthermore, the grandfather protection serves as an important safeguard for other generally imposed business taxes not specifically exempted from the moratorium.

PREPARED STATEMENT OF JOE HUDDLESTON, EXECUTIVE DIRECTOR,
MULTISTATE TAX COMMISSSION

**STATEMENT OF**
**JOE HUDDLESTON**
**EXECUTIVE DIRECTOR**
**MULTISTATE TAX COMMISSION**
**IN OPPOSITION TO**
**H.R. 743, PERMANENT INTERNET TAX FREEDOM ACT OF 2007**
**AND**
**H.R. 1077, INTERNET CONSUMER PROTECTION ACT OF 2007**
**BEFORE THE**
**SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW**
**JULY 26, 2007**

Madam Chairwoman, Ranking Member Cannon, and Members of the Subcommittee on Commercial and Administrative Law:

My name is Joe Huddleston and I am the Chair of the Multistate Tax Commission. The Multistate Tax Commission (MTC) is an intergovernmental State tax agency working on behalf of States and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Created by the Multistate Tax Compact, the Commission is charged with:

- Facilitating the proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;

- Promoting uniformity or compatibility in significant components of tax systems;
- Facilitating taxpayer convenience and compliance in the filing of tax returns and other phases of tax administration; and
- Avoiding duplicative taxation.

Established in 1967, forty-seven States and the District of Columbia participate in the work of the MTC.

Thank you for the opportunity to present our views. The MTC Chairman, Joan Wagnon, Secretary of Revenue for the State of Kansas, submitted a statement for the Subcommittee's May 22, 2007 hearing record on this topic. That statement addressed each of the arguments that the proponents of this legislation made at that hearing and concluded that the proponents had failed to make their case.. The purpose of this statement is to address statements made during the July 26, 2007 hearing.

The MTC is very appreciative of the Chairwoman's opening remarks that, "Congress understood that, when considering a moratorium on taxing Internet access, it should balance the interests of state and local government to collect revenue while encouraging the development of the Internet and its related industries." Further, she stated that the Internet Tax Freedom Act was intended by Congress only to be a temporary solution until the Internet industry was able to stand on its own. Today, as the Chairwoman noted, the Internet is a $100 billion industry.

Rep. John Campbell, the chief sponsor of H.R. 1077, the Internet Consumer Protection Act of 2007, stated in his testimony that the cost of Internet access continues to drop significantly because Internet service providers are able to earn far greater revenue through advertising. He further stated that many communities, including

Anaheim in his Congressional District, offer free Internet access to their residents. He cited these developments as a trend toward universal free Internet access. Given this trend, there is no need to enact federal legislation to permanently prohibit taxation of Internet access. The market appears to be taking care of itself.

Rep. Anna Eshoo, the chief sponsor of H.R. 743, the Permanent Internet Tax Freedom Act of 2007, stated in her testimony that, "According to the most recent data, the U.S. now ranks 24th in broadband penetration among all industrialized countries…Allowing this moratorium to expire would …disincetivize broadband access for every American (Underlining in printed statement)." This was the primary rationale in her testimony for passage of this legislation.

Yet, according to report issued just this month by the Center on Budget and Policy Priorities, all of the developed nations that have achieved a higher rate of household broadband adoption than the United States have taxes that are **2-3 times higher** than typical state and local tax rates. In fact, "the world leader in broadband penetration, Denmark, taxes Internet access at a 25 percent rate," M. Mazerov, "Making the 'Internet Tax Freedom Act' Permanent Could Lead to a Substantial Revenue Loss for States and Localities," Center for Budget and Policy Priorities, July 11, 2007. Clearly the taxation of Internet access is not an impediment to broadband penetration or Internet innovation.

The Multistate Tax Commission urges the Members of this Subcommittee to reject H.R. 743 and H.R. 1077 as unwarranted intrusions into state and local taxation authority. Thank you for the opportunity to present these views.

○