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FULL COMMITTEE HEARING ON THE INTERNET TAX MORATORIUM: THE POTENTIAL NEGATIVE IMPACTS ON SMALL BUSINESSES OF ALLOWING MORATORIUM TO EXPIRE

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF
REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

OCTOBER 3, 2007

Serial Number 110-49

Printed for the use of the Committee on Small Business

Available via the World Wide Web: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

38–207 PDF WASHINGTON : 2007

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

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FULL COMMITTEE HEARING ON THE INTERNET TAX MORATORIUM: THE POTENTIAL NEGATIVE IMPACTS ON SMALL BUSINESSES OF ALLOWING MORATORIUM TO EXPIRE

Wednesday, October 3, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [Chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Grijalva, Braley, Clarke, Ellsworth, Johnson, Sestak, Hirono, Chabot, Akin, Fortenberry, Gohmert, Heller, Davis, Fallin, and Jordan.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

ChairwomanVELÁZQUEZ. Good morning. I now call this hearing to order on the Internet tax moratorium, the potential negative impacts on small businesses of allowing the moratorium to expire.

With the advent of the Internet, electronic commerce has been a driving force for economic growth in our country. Small businesses in particular have played a vital role in the digital economy where many entrepreneurs and Internet connections can serve as an avenue to start a new business or grow an existing one.

Today's hearing will focus on the Internet tax moratorium and its spending expiration. Since 1998, federal law has prohibited taxes on Internet access and has insured priority between online and off-line sales.

As we have witnessed over the past 15 years, the Internet has proven to be the great leveling field in American business today, permitting small firms with fewer resources to compete. In a recent survey of small business owners, 83 percent reported that the Internet had improved communications about their company. Additionally, over 60 percent stated that the Internet has opened up new markets for their businesses.

The current moratorium has played an important role in encouraging Internet sales for small businesses. However, with many states and local governments under pressure to find additional sources of revenue, some have advocated against extinction.

Today's discussion will examine the impact the expiration will have on small businesses competing in a technology driven economy. It is fairly clear that the moratorium has been a catalyst for

the growth in E-commerce among smaller companies. The current nondiscriminatory tax treatment has allowed many small businesses to use the Internet as another medium to expand.

While the overall degree of impact may be argued, the growth by small businesses in Internet commerce cannot. eBay alone reports that approximately 250,000 sellers make their full-time living from home-based businesses. They are earning unpredictable taxes, many of which will be regressive in nature, could place small businesses at a disadvantage.

Studies have shown that a hike in these taxes could hit the smallest E-retailers the hardest. It could also add significant paperwork burdens for small businesses that simply do not have the resources to meet the new requirements.

While some may discount the impact of higher access fees, it is important to consider the overall price sensitivity of the market. Assuming that Internet access is taxed similarly to wireless communications, small businesses could see an upwards of 15 to 30 percent increase in their Internet bill. For some that could make the difference in the decision whether to market products and services on line.

The moratorium was created as an economic policy to allow small businesses to compete. The prohibition has made the Internet a gateway for entrepreneurship, regardless of race, income or neighborhood. Many of the most commonly known Internet companies in the world, including eBay, Amazon, and Google, started as very small Internet companies. We should be careful to make sure we are not preventing the next Google.

At a time when small businesses face many obstacles, we should be advancing policies that help small firms compete in our digital economy. With the moratorium set to expire in a little less than a month, it is important for the Committee to fully understand the implications if Congress fails to act.

I appreciate the witnesses coming here to discuss this important issue and look forward to your testimony.

I will now yield to the Ranking Member, Mr. Chabot, for his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr.CHABOT. Thank you, Madam Chair.

And good morning. I want to thank all of the witnesses for being here today to examine the negative effects of allowing the Internet tax moratorium to expire.

I also want to thank you, Madam Chair, for holding this very important hearing, and I agree with almost all of the comments, if not all of the comments, that you mentioned. I think you are right on point.

Since 1998, Congress has insured that Internet access is not subject to either state and local taxes or multiple and discriminatory taxes on Internet commerce, regardless of the technology consumers use to access the Internet. If the moratorium is allowed to lapse, American taxpayers could be exposed to countless new and onerous taxes from states and municipalities simply for accessing the Internet.

The Internet has changed the way we communicate, as the Chair mentioned, the way we learn and do business, all for the better. Since the moratorium was first adopted, tremendous investment, growth, and innovation in the scope and use of the Internet has occurred.

By preventing unnecessary taxation of the Internet, Congress fostered growth and productivity and innovation and widened public access to information. While Americans use the Internet for a myriad of reasons, E-commerce has particularly flourished and continues to grow at an exceptional rate. In 2006 alone, online retail sales exceeded $100 billion, increasing 24 percent over the previous year.

This is especially important to small businesses as the Chair mentioned. An Internet connection opens doors to the rest of the world. No longer must an entrepreneur focus his or her marketing strategies to just their neighborhood. With the advent of the Internet, the world is their neighborhood and, quite literally, the sky is the limit.

Although this expansion is impressive, there is still more that we must do to insure equal access among all Americans. Internet usage still lags behind in rural and lower income areas, and many experts have reported that the United States has fallen from fourth to around sixteenth in broadband deployment since 2001.

In order to reverse this trend we must keep Internet access costs as a minimum. Prohibiting unnecessary taxes will help accomplish this goal.

In addition to making the moratorium permanent, I believe we ought to reexamine the grandfather clause as well. I have been and still am concerned about this provision because I believe it rewarded a handful of state tax administrators who rushed to tax Internet access.

With America's small businesses already strapped with high legal costs, regulatory burdens, onerous taxation, high energy prices, and rising health care costs, they should not be slapped with new taxes on Internet access. Simply put, allowing the moratorium to expire would result in a tax increase on small businesses and on American families.

Permanently extending the moratorium would allow the unfettered growth of the Internet and E-commerce to continue. Tax cuts, innovation, and the free market are the surest formula for economic growth and prosperity. The surest way to stifle achievement, progress, and growth is to involve the government.

The evolution of the Internet has directly contributed to the growth of the U.S. economy. As Internet usage has grown, so has E-commerce. Every day millions of Americans are online making various transactions from buying products to managing their bank accounts. By making permanent the Internet tax moratorium, Congress can assure that this vital tool remains a key driver of economic growth.

Again, thank you, Madam Chair, for calling this hearing on such a critical and timely issue. I look forward to the witnesses' testimony, and I yield back the balance of my time.

ChairwomanVELÁZQUEZ. Thank you.

And now I recognize Mr. Braley for an opening statement.

OPENING STATEMENT OF MR. BRALEY

Mr.BRALEY. Thank you, Madam Chairwoman, and thank you for holding this hearing.

As the Chair of the Contracting and Technology Subcommittee, I work with Ranking Member Davis very often to talk about the intersection of issues of technology and their impact on small businesses, and that is why I am so pleased that we are having this hearing today.

We are here today to talk about an important issue, the Internet tax moratorium, which began in 1998 and is set to expire on November 1st. That is why it is essential that we take a look at this issue now. The expansion of electronic commerce in this country can be directly related to the affordable Internet access and tax parity between online and off-line sales.

The Internet, as we all know, has become a huge economic development tool, especially for small businesses, many of which are located in remote parts of this country. If we make this moratorium permanent, this will allow these small businesses to know what costs they will be dealing with as they attempt to start new ventures or expand upon an existing one.

Many of these small businesses will go on to become large Internet companies and have the potential to employ thousands of Americans and add billions of dollars to our economy. eBay, which has already been mentioned, is one of the companies represented by our panel today, is certainly a prime example of this.

We as a government have a responsibility to promote a permanent tax moratorium on the Internet when there is still so much untapped potential in the electronic commerce industry. That is why I am a proud co-sponsor of H.R. 743, the Permanent Internet Tax Freedom Act. In addition to helping small businesses grow, a permanent Internet tax moratorium will help insure that all Americans can afford Internet access. It will also promote further broadband deployment in rural areas, such as in many parts of my district in Iowa, which still lack affordable access to high speed Internet.

If taxes on Internet access are raised, the number of consumers who are able to afford it will go down. If the Internet were taxed similarly to wireless communications, many consumers and small businesses would see upwards of a 17 percent increase in their Internet bill. For small companies operating on thin profit margins, this increase could make the difference between their success or failure.

I look forward to hearing from our witnesses today and hearing how an extension of the tax moratorium would affect each of them. It is essential that we act promptly on this legislation to extend the Internet tax moratorium before the current legislation expires on November 1st. Our nation's small businesses are counting on us.

Again, thank you, Madam Chairwoman, and thank you to the witnesses for joining us today.

ChairwomanVELÁZQUEZ. Thank you.

Does any other member seek recognition for the purpose of an opening statement?

[No response.]

ChairwomanVELÁZQUEZ. I also want to take a moment to introduce a new member of this Committee, Mazie Hirono. She is currently serving her first term representing the Second District of Hawaii in Congress. She sits on the Committee on Education and the Committee on Transportation and Infrastructure.

She recently joined the Committee on Small Business. Ms. Hirono is welcome to this Committee.

Ms.HIRONO. Thank you, Madam Chair.

ChairwomanVELÁZQUEZ. And so we are going to start with our witnesses. Our first witness is Mr. Brian Bieron. Mr. Bieron is the Senior Director of Federal Government Relations for eBay Inc.

Founded in 1995, eBay Inc connects hundreds of millions of people around the world every day empowering them to explore new opportunities and innovate together. eBay Inc. does this by providing the Internet platforms of choice for global commerce, payments and communications. Since its inception, eBay has expanded to include some of the strongest plans in the world, including eBay, Paypal, Skype, Shopping.com, and others. eBay Inc. is headquartered in San Jose, California.

Mr. Bieron, you will have five minutes to make your presentation. Welcome.

STATEMENT OF BRIAN BIERON, SENIOR DIRECTOR, FEDERAL GOVERNMENT RELATIONS, eBAY INC.

Mr.BIERON. Thank you very much.

Madam Chairwoman, Ranking Member Chabot, and members of the Committee, I would like to thank the Committee for giving eBay this opportunity to discuss the importance of the Internet access tax moratorium to small businesses.

At eBay, first of all, we agree with the opening statements. They are far more eloquent than mine will be. So thank you for beginning on such a high note.

We believe that the Internet is a good thing. We believe that it is a remarkable, revolutionary, empowering technology. Of particular importance to this Committee should be the fact that the Internet is a powerful force supporting American small business success in the global 21st Century economy.

Today small retailers across America are using eBay to reach a global customer base. Some are primarily eBay based businesses. Many use eBay as well as other Internet channels to reach Internet enabled consumers.

Finally, more and more traditional brick and mortar retailers are augmenting their storefront business with Internet sales. All in all, we estimate that over 720,000 small businesses use eBay in the United States as a primary or secondary marketing channel.

The evolution of brick and mortar small businesses adopting the Internet is a particularly interesting story. There was a time when many traditional small business retailers seemed threatened or maybe awed by the Internet. It was a "gee whiz" technology that might make sense in Silicon Valley, but what did it have to do with a small retailer trying to stay afloat on Main Street in towns and small cities across America?

The reality of the past decade is that the Internet has proven to be a remarkable tool for those small businesses. In the retail indus-

try, small entrepreneurs face a world of global behemoths. Those multi-billion dollar businesses source product globally and use technology to relentlessly increase efficiency and drive down prices.

Mega retailers have been relentlessly pressuring small business retailers for decades. In a word, the Internet has been a lifeline for many of those small businesses. The Internet allows a small retailers to tap into the global economy in two key ways.

First, the small business can use the Internet, the ultimate open and level playing field, to reach a global customer base. For example, approximately 15 percent of the sales of U.S. small businesses using eBay are cross-border sales, and those numbers are going up.

Yes, eBay is enabling a small business export success story. This holds tremendous hope for U.S. small business growth.

Second, the Internet increasingly allows small businesses to source their products globally. The mega retailer is a global giant buying from factories in every country of the world and selling from stores in every corner of America. Now, the Internet allows the small retailer to likewise find the best products at the best prices anywhere in the world.

So what does this mean for your consideration of the Internet access tax moratorium? We believe that you should take up the mantle of Internet enabled small businesses and call on your colleagues to extend the moratorium on access taxes and multiple indiscriminate taxes on the Internet permanently.

By the way, along with learning quite a bit from our community about how small businesses use the Internet, we also think that we have learned a little bit about how markets work. In fact, eBay has often been called the most perfect market. Our marketplace is super efficient benefiting hundreds of millions of consumers worldwide and hundreds of thousands of small businesses.

We know that when you raise prices you reduce demand. Anybody or any study that tries to make the case that even if you raise prices you will not reduce demand is highly suspect on its face. If taxes on Internet access go up, fewer small businesses will use the Internet.

More importantly, fewer consumers will use the Internet, and for small businesses using the Internet, that means fewer sales and less opportunity to compete with the big retailers. That is bad news.

So in conclusion, we support maintaining the core regulatory principles that have underpinned the Internet as a small business success story. On the tax front, this includes policies such as the tax free treatment of Internet access.

This Committee should make a strong statement for small business by calling on your House leadership to rapidly bring a permanent tax moratorium to the House floor.

Thank you, and I am happy to answer any questions.

[The prepared statement of Mr. Bieron may be found in the Appendix on page 38.]

ChairwomanVELÁZQUEZ. Thank you, Mr. Bieron.

Our next witness is Mr. Brett Dewey. Mr. Dewey is the President and CEO of WickedCoolStuff.com, which is based in North Holly-

wood, California. Mr. Dewey's company, owned by him and his wife, sells toys, tee shirts and other small gifts exclusively online.

Started in 1999, it employs six full-time employees throughout the year and increases its staff during the holiday season. Mr. Dewey's testimony will focus on the potential negative impacts that an expiration of the moratorium will have on a business such as his.

Welcome, sir.

STATEMENT OF BRETT DEWEY, CEO, WICKEDCOOLSTUFF.COM

Mr.DEWEY. Thank you, Chairman Velázquez, Ranking Member Chabot, members of the Committee.

Good morning. Thank you for inviting me to be here today. It is quite an honor.

My name is Brett Dewey, and I own a small online company called WickedCoolStuff.com that sells toys, tee shirts, and other gifts that we think are wicked cool.

I hope my testimony helps explain some of the importance of extending the Internet tax moratorium. Unlike a lot of people you may hear from, I am not part of a formal coalition or any an experienced insider. In fact, this is the first time I have done more than vote or write a letter to my Congressman.

I got here using frequent flyer miles earned on my company credit card. I am sleeping on a friend's sofa. I have to say this room seems a lot smaller on TV.

WickedCoolStuff.com is a real, live Mom and Pop operation. My wife Cynthia and I run the company out of a warehouse in the San Fernando Valley region of North Hollywood, of Los Angeles. Our son Alex is almost three and primarily helps by playing hide and seek among the shelves and boxes.

We have five full-time permanent employees, and as the Christmas holiday approaches, we will probably add eight full-time seasonal staff to help with the rush.

Cynthia and I provide health insurance to our full-time employees after they have been with us several months, and we would like to do more, but we cannot afford to. We try to be good employers and good community members. We believe that makes good business and is the right thing to do.

The Internet tax moratorium has been in place since before we started WickedCoolStuff.com eight years ago. Letting it expire now would be a new tax on our small business and one we cannot afford.

Just like every other small business, ours has its ups and downs. Right now, like many small, online retailers we are in a down. We are taking steps to improve sales, and I am optimistic we are headed for another up. But a new tax right now would be devastating to our business. At the moment we are looking up, but a new tax would have us looking out.

We started WickedCoolStuff.com eight years ago in a spare bedroom. When the boxes took over the living room, den, garage and started to creep into the kitchen, we decided it was time to get a warehouse. Since then we have grown to as many as seven full-time employees and sales over 1.3 million at our peak, down to our

current level of five full-time employees and projected sales of under a million this year.

In our best year, Cynthia and I paid ourselves about $60,000, although this year we are unlikely to draw any salary, relying on savings and a home equity line to keep our home running.

I have prepared a small chart that is included in my written testimony to help explain the financial realities of a small company like ours and why letting the Internet tax moratorium expire now would be so devastating. These numbers are based on our experience, and while they may not withstand an IRS audit, they give you a pretty good idea of what it costs to run a very small business like ours.

The handout is for a hypothetical company called HypotheticalExamples.com. An online retailer expects to sell a million dollars of small plastic hypotheticals this year. Most of the company's income goes to buy wholesale goods, which cost about $500,000. Another 200,000 goes to shipping those goods both from the wholesalers to the warehouse and then again out to the consumers; $135,000 for salaries, none of which goes to the owners; 17,200 goes to health insurance; 15,000 for payroll taxes; rent is 33,500; marketing is another 34,000; Internet and E-commerce hosting, 19,000; another 9,950 to various local taxes and workmen's compensation; $34,000 goes to utilities, bookkeeping, bank fees and insurance. That leaves just under $2,000 for the owners of HypotheticalExamples.com to share as a salary, which comes to roughly 17.50 a week each.

While this may not sound like WickedCoolStuff.com and may sound like less, the numbers are drawn from our experiences. It is not our company. We are unlikely to do even that well this year. Cynthia and I are working hard to turn our company around, and we are confident we can. We are actively adding new features, new products, and trying new marketing.

But letting the Internet tax moratorium expire would derail those efforts and with it our company. Our options would be to lay off employees, stop providing health insurance for our staff, and their families rely on it, or close our doors completely.

A new tax now would be the equivalent of changing the rules in the middle of a game we are currently not winning.

Thank you, again, for inviting me here today. I hope that my testimony has been helpful. Typically I would give you all a WickedCoolStuff.com gift certificate or a Star Wars bobble head as a thank you, but I understand there are rules about that sort of thing.

[Laughter.]

Mr.DEWEY. Instead, I encourage you to visit our Web site and purchase one for yourself and your staff and maybe your constituents. We could use all of the help.

I look forward to your questions.

[The prepared statement of Mr. Dewey may be found in the Appendix on page 40.]

ChairwomanVELÁZQUEZ. Sure. Thank you very much for you testimony.

Our next witness is Mr. David P. McClure. He is the President and Chief Executive Officer or the U.S. Internet Industry Association, the primary U.S. trade association for Internet commerce and connectivity.

Mr. McClure has written and lectured extensively on management and technology issues and is considered an authority on strategic business planning, telecommuting, technology policy, and technology integration for businesses with members of every site engaged in virtually every facet of the Internet. USIIA works to craft a business environment in which Internet companies can thrive.

Welcome, sir.

STATEMENT OF DAVID P. McCLURE, PRESIDENT AND CEO, U.S. INTERNET INDUSTRY ASSOCIATION

Mr.MCCLURE. Thank you very much.

Chairwoman Velázquez and members of the Committee, thank you for the opportunity to speak.

My name is David McClure, and I am President of the U.S. Internet Industry Association. For 15 years, we have been a trade association that serves businesses engaged in Internet connectivity, online content, and electronic commerce. Our members, the majority of which are small businesses, are concerned that without your action they are going to immediately be subjected to multiple, discriminatory, retroactive and crippling taxes. The impact of allowing the Internet Nondiscrimination Act to expire without extension would be felt specifically in three ways by small businesses.

First, they would see an immediate loss of customers. It was alluded to before by Mr. Bieron, and we have data to back it up, that Internet connectivity is price elastic. That means as the price goes up, demand and use goes down.

Studies by Ernst & Young, by the University of Massachusetts and others have confirmed this elasticity. You can also look at the data by the Pew and Internet Life Project, which for the past decade has tracked this extensively. If taxes are permitted that would raise the cost of basic Internet access and raise it by as much as 30 percent, by the way, the predominantly working families that are not on the Internet today would not be able to get there, and families that now have basic Internet access would not be able to afford it any longer.

Secondarily, there would be a loss of opportunities for small businesses to survive and to grow. In today's economy, small businesses in America are able to compete globally due in part to this nation's superior infrastructure. The Internet backbone, our rich diversity of broadband, and the growing wireless network spanning almost every corner of the nation, but the growth of this infrastructure depends on sustained and increasing levels of private investment. We are looking at as much as one trillion dollars that will need to be invested between now and the year 2015.

If the tax moratorium is not extended, states and localities by their own numbers will take about 35 billion dollars a year out of our industry in taxes and that does not count the cost of compliance. That is raw taxes.

If you add that up, between now and 2015, that is $320 billion. That is almost a third of the trillion dollars we are going to need to build and sustain the kind of broadband network this country needs and deserves.

Again, that is not counting the cost of compliance. And I want to talk about the cost of compliance because that is really the most crippling effect. Look. We know from an Ernest & Young study of the cost of compliance for sales taxes that the burden is disproportionate. If you look at companies selling nationally with collection responsibilities for taxes, in the 46 states that do collect taxes, 14 percent of their sales go to sales taxes, 14 percent for a large company.

For a mid-size company, that goes up to 48 percent, but here is the shocker. For a small company, 87 percent of their sales tax goes to the cost of compliance. These are companies that do not have fully staffed tax compliance departments. They cannot afford it. They are not going to be able to maintain it.

The original Internet Tax Freedom Act was not as some have retroactively suggested, an effort to give states time to find a better way to tax. I was there. I helped draft the Internet Tax Freedom Act in 1998 for Senator Wyden, and it was an alarmed and informed response to a significant pattern of abusive, punitive, and destructive taxes passed by local authorities with little regard to how their actions would affect consumers, businesses, the economy or our national interest.

It was Congress' way of putting an end to this abuse. John Marshall, the U.S. Supreme Court Justice who shaped much of our Constitutional law, noted that the power to tax involves the power to destroy; that the power to destroy may defeat the power to create. There is no clearer example of how this abuse of power and its negative impact on creativity will affect us than the imposition of multiple discriminatory and predatory taxes on America's small businesses.

Thank you.

[The prepared statement of Mr. McClure may be found in the Appendix on page 42.]

ChairwomanVELÁZQUEZ. Thank you, Mr. McClure.

Our next witness is Mr. Ross Lieberman. Mr. Lieberman is the Vice President of Government Affairs for the American Cable Association.

Based in Pittsburgh, the American Cable Association is a trade organization representing 1,100 smaller and medium size independent cable companies who provide broadband services for more than eight million cable subscribers primarily located in rural and smaller suburban markets across America.

In his role with ACA, Mr. Lieberman is the trade association's senior government advocate overseeing all Capitol Hill and Federal Communications Commission activities.

Welcome.

STATEMENT OF ROSS J. LIEBERMAN, VICE PRESIDENT OF GOVERNMENT AFFAIRS, AMERICAN CABLE ASSOCIATION

Mr.LIEBERMAN. Thank you.

Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee, thank you for inviting me to testify on the Internet tax moratorium and how its potential expiration would impact small cable and broadband providers and consumers across the country.

My name is Ross Lieberman, and I am Vice President of Government Affairs for the American Cable Association. In a telecommunications world that is dominated by industry giants, ACA is the voice for nearly 1,100 small and medium sized cable companies that serve more than eight million subscribers. Our members range from family run cable businesses serving a single community to multiple system operators that focus on smaller markets in rural areas. The average operator size is about 7,500 subscribers, but some ACA members serve fewer than 1,000.

ACA members are vital businesses in their communities. In addition to providing broadcasting cable programming, many of our members offer unique local programming, such as high school sporting events and religious services that are not available from satellite TV companies. Most importantly for the purposes of this hearing, our members are rolling out high speed Internet access in their communities where no other company offers it.

The ACA supports continuing the Internet tax moratorium. At a time when the costs of running their businesses are increasing, small cable operators are deploying broadband despite the financial hurdles of offering such services. Congress can safeguard these investments and insure high speed Internet access remains affordable by passing legislation that prevents state and local governments from imposing taxes on these services.

Small cable providers offer broadband services at reasonable prices. Operators in rural America where the median household income is below national averages are particularly aware that their customers cannot afford to over spend on products and services, including high speed Internet access. If broadband is priced too high, then take rates will suffer.

Our members face various economic challenges offering broadband in their markets. First, the cost to upgrade a cable only system to provide Internet access is more difficult to recoup for operators with a small number of subscribers. Whether serving 5,000 or 500,000 customers, cable operators must purchase some of the same equipment.

Second, the cost of maintaining a cable network is high when the distance among subscribers is great. A small cable company might need an employee to travel an hour or more to make a service call to a subscriber's home.

Third, access to capital can be difficult. To pay for the necessary upgrades and maintenance costs, many of our members must turn to bankers on their local main streets, not financiers on Wall Street.

At this time, small cable operators' overall business costs are increasing. The most significant concern for ACA members is the rising cost of cable and broadcast programming. Small cable operators have no leverage in negotiations with network broadcasters and national programmers who demand double, even triple the fees previously paid for the same content.

Small cable operators are also troubled by costly regulations, particularly new ones recently placed upon them by the FCC. On June 1st, the Commission mandated that cable operators begin to apply more expensive digital set top boxes with separable security to their subscribers.

Then on September 11th, the Commission adopted rules that force cable operators to carry certain broadcast stations in both digital and analog formats, requiring our members to make costly upgrades to their systems. This is important. These costs are making it difficult for our members to remain viable and reinvest in affordable advanced services for their communities.

The ACA supports continuing the Internet tax moratorium and urges Congress to pass legislation before the ban expires on November 1st. Our members are concerned that an expiration of the moratorium could have an unfavorable impact on their businesses and communities. Without the moratorium, state and local jurisdictions are likely to impose a patchwork of new taxes on American consumers and businesses simply for acquiring the broadband connection. These taxes would increase prices and make Internet access less affordable for consumers.

New taxes on broadband access would be especially problematic if excessive state and local cable taxes were simply extended to the Internet. Most cable subscribers already pay a franchise fee of up to five percent. Imposing similar taxes on broadband access would discourage some consumers from signing up for the service.

To tax a service that is neither fully deployed nor adopted seems to contradict congressional intent to expand broadband coverage and penetration.

Our members who live in the towns in rural areas they serve also support the Internet tax moratorium because they know first hand how broadband access has improved their communities. It has made their towns a better place to live, work and raise a family.

In addition to offering the service to consumers, some of our members provide broadband to their local hospitals, schools, and businesses, enhancing their home town's overall quality of life. At a time when the benefits of these services are coming to rural America, our members believe government should continue to take its hands off approach with respect to taxes.

Chairwoman and members of the Committee, thank you again for the opportunity to testify on this topic of importance to small cable operators and consumers.

[The prepared statement of Mr. Lieberman may be found in the Appendix on page 44.]

ChairwomanVELÁZQUEZ. Thank you very much, Mr. Lieberman.

Our next witness, Mr. Raymond Keating. Mr. Keating is the Chief Economist at the Small Business & Entrepreneurship Council.

SBEC is a small business advocacy group with more than 70,000 members across the nation. As Chief Economist, Mr. Keating writes and speaks on a wide range of issues impacting the entrepreneurial sector of the economy.

Furthermore, he is an expert on taxation, federal, state and city budget issues, and a host of other small business issues.

Welcome, sir.

STATEMENT OF RAYMOND KEATING, CHIEF ECONOMIST, SMALL BUSINESS & ENTREPRENEURSHIP COUNCIL

Mr.KEATING. Thank you very much.

Chairwoman Velázquez, Representative Chabot, members of the Committee, I very much appreciate you having this hearing today and inviting us to speak.

As you mentioned, I am Chief Economist with the Small Business & Entrepreneurship Council. We have members all across the nation. We are nonpartisan, nonprofit, and we work on public policy issues really from A to Z that impact small businesses and entrepreneurs, and that obviously includes the Internet tax moratorium, the moratorium on Internet access and multiple and discriminatory E-commerce taxes.

And we strongly favor making that moratorium permanent. I would like to touch on four points very quickly regarding this issue. The first one is the economy, and as we all know, I think the watchword right now in the economy is uncertainty, and you can look at a whole host of issues, positives, negatives.

On the negative side, you have energy costs, housing and subprime lending problems, consumers being somewhat less confident, and some recent disappointing reports on retail sales and manufacturing production.

On the flip side, there are positives. There is certainly rising household net worth, increasing investment in nonresidential structures. Exports look good, and there is good growth in real disposal personal income in recent months.

And then, of course, there is a whole host of mixed issues out there right now. Real GDP growth was pretty good in the last quarter, but not so great since late 2005. A critical issue is private domestic investment, private sector investment. That was up again in the most recent quarter, but it was down in the previous three. And of course, employment growth is a big issue, and we saw that the last month that we have data for that was not good news. But if you look back a little farther, there certainly are positives.

So in this mix comes tax policy, and it certainly matters a great deal. And, again, there is a lot of uncertainty there. If you look at the broader tax issue of the 2001 and 2003 tax measures, those are due to expire soon. So what is going to happen there? Obviously entrepreneurs and small businesses are very concerned. Are they going to be extended? Are they going to be made permanent? Are some of them going to be allowed to expire and thereby imposing a large tax increase?

And the Internet tax moratorium access on the Internet taxes, on Internet access is a big issue there, and it is another uncertainty for many small businesses. The possibility that states and localities could be imposing tax increases on Internet access in E-commerce would loom as a very big uncertainty and a very big problem for a lot of small businesses. That is number one.

The second issue that I would like to talk about is broadband access and investment. Higher taxes on Internet access would mean

that the growth in broadband access would be restrained, and that would take a competitive disadvantage that we have right now and make it worse.

You will see in my written comments that we broke out a table on where the U.S. ranks in terms of broadband household penetration rates among various developed nations and unfortunately come in last. So creating more uncertainty and opening the door to higher Internet taxes are not positive policy developments for investing in those networks.

All of these things obviously affect small businesses, but then there is the direct impact on small business. They will be hurt in various ways. Obviously the taxes they pay for Internet access, the reduced customers via the Internet and their goods and services potentially facing multiple and punitive levels of taxation. These are all significant negative threats to the bottom line of small businesses across the country.

As many people have mentioned here so far today, advancement in the computer and telecommunications technologies have been invaluable for the success of small businesses, and that is a big reason why we need to make this Internet access tax moratorium permanent.

And the final issue I would just like to bring up is about state and local government. There are many state and local officials that do not like the idea of a permanent band on Internet access taxes. Unfortunately, folks tend to view the Internet as a cash cow to be milked rather than a source of economic opportunity for all, and the argument is often made that without these additional revenues, somehow or other we will be denied the revenues for necessary services, vital services from state and local governments.

But when you look at the numbers, it is really hard to accept that, I think. Really state and local governments have been quite literally in the taxpayer dough. When you look at total revenues, from 1995 to 2005, that is the most recent data that we have from the Census Bureau, total revenues went from 1.4 trillion to 2.5 trillion for state and local governments across the country. That was a 78 percent increase compared to about 22 percent in inflation over that same period, and part of that was sales and gross receipts taxes, and those jumped 62 percent over that period.

And of course, keep in mind more revenue in the hands of government means fewer resources left in the private sector for consumption, investment, and job creation. If Congress wants to hamper the Internet and related economic opportunities in growth, then clearly this Internet tax moratorium should be ended, but if they wish to see the full potential of the Internet realized, then the current tax moratorium should be made permanent.

Thank you very much, and I look forward to your questions.

[The prepared statement of Mr. Keating may be found in the Appendix on page 50.]

ChairwomanVELÁZQUEZ. Thank you.

And now I would like to address my first question to Mr. Dewey. Not only are you a voter, but also you are a real person. It is really great to have real people here.

I assume that affordable broadband access has been a crucial factor in allowing you to effectively operate your online store. Would you have been hesitant entering this industry had you known the rules of the game could possibly be changed and new or unpredictable taxes could be levied on your business?

Mr.DEWEY. Oh, yeah. It is making me nervous right now. We have got a business model set up, and as I stated before, it has been a shaky year. So if you throw something new at me or something unpredictable or something where I have got to take care of taxes in many different places, then definitely it is going to affect our business in the negative.

ChairwomanVELÁZQUEZ. Thank you.

Mr. Bieron, due to the fact that many states did not have the ability to tax Internet access when the moratorium was enacted, there is very little data as to what an Internet access tax might look like. Of the states that are levying Internet access taxes, Hawaii levies its general excise tax, New Hampshire its communication services tax, and Washington State its business and occupation tax.

If there is a way to predict, what services will be taxed if the moratorium was not extended and at what rate?

Mr.BIERON. I mean, I would agree that it is very difficult to predict, although some of the witnesses have referred to some either current cable level taxes or current cellular phone level taxes. I think at eBay we are concerned about two things.

First of all, whatever type of tax they choose to just levy on access, it is going to reduce demand, and so in particular, reducing consumer demand is a bad thing in the business that we are in, and more importantly, in the business that our small business retailers are in.

But then, half of the regime is also the prohibition on multiple and discriminatory taxes. We have always looked at that as the prospect that if that prohibition is not there, the incentive is created at the state and local level to potentially try to use taxes to discourage distant type of businesses where local business interests could attempt to encourage their elected representatives at the local level to impose taxes that would give them a benefit because it would be a higher level of tax on Internet enabled businesses.

We think that the—and honestly, only people's creativity and, more importantly, government's creativity to structure taxes would limit how that could be done.

And so we would simply see that as a great danger. If you open up that flood gate, it is hard to predict how it would be used, but certainly any small business that is trying to use the Internet to reach customers far away potentially competing with business locally, I mean, we see the future as essentially small business everywhere adopting the Internet to help run their business, but that creates, unfortunately a competitive dynamic that would be bad.

ChairwomanVELÁZQUEZ. That was my follow-up question. Thank you.

Mr. McClure, when Congress first passed the ban on Internet taxes in 1998, the Internet did not provide many of the services that we now use, such as music and video. Some say that Internet

service providers may attempt to bundle these extra services with Internet access to avoid paying taxes.

Is it possible, given the way the moratorium is now worded, that Internet service providers may be able to bundle services together to avoid taxation?

Mr.MCCLURE. No, I think we have seen clearly that there has been a division. After all, this law has not stood alone since 1998. We have gone through two revisions of it, and in both cases the states and municipalities have had the opportunity to come back and say, "We are concerned about this issue," and it gets addressed in those processes.

What I find interesting now is they are using as an example, voice-over IP that somehow if voice-over IP is included in this taxing regime, that they will be able to bundle them and somehow be able to avoid taxes. That is not really the case. The reality is the voice-over IP is an Internet service. It is packet switched telephony, and it is by virtue of federal court decisions not the venue of the state under the Commerce Act, the commerce clause of the Constitution.

It is not the purview of the states to tax it. So it is not a question of somehow this act is preventing them from taxing legitimate things they might otherwise tax. The carve-out is very clear. We are not looking to expand it. We are simply looking to protect what we see as protection of American consumers against very predatory taxes.

ChairwomanVELÁZQUEZ. Thank you.

And in light of the members that are here, I am going to recognize Mr. Chabot, but once we finish with all the members, I will come back and ask more questions.

Mr.CHABOT. Thank you, Madam Chair.

Mr. Dewey, I think I will start with you as well. We were just going on one of our Blackberries back here on your Web site, and we think it has got a great Web site.

[Laughter.]

Mr.CHABOT. But I was just thinking with your name, the WickedCoolStuff, which is a very clever name, I think, you know, if we had started a business like this, if I had the money, say, back in high school and a good idea and the Internet existed back in the late 1960s when I was in high school, we might have called it GrooveyStuff or FarOutStuff or something like that.

I am just wondering if the name. Are you concerned that it might be dated down the road and WickedCool might be pretty lame somewhere down the line?

Mr.DEWEY. Not a concern yet, but we are always looking to the future.

Mr.CHABOT. Good. What are some of your better selling items, shall we say? We will give you a little free advertising here.

Mr.DEWEY. One constant seller would be the classic Superman tee shirt. We sell that big S logo worldwide around the world. Every day we sell a shirt like that. We sell tee shirts and bobble heads and gift items and things like that, movie and cartoon inspired items that people enjoy and especially at gift time.

Mr.CHABOT. Very good, and we wish you the best. I hope there are a lot of folks that take your example and create jobs, and I es-

pecially was impressed, and I think the Chair was as well, that you are paying health care for your employees even though you are not rolling in the cash yet. Hopefully you will be some day. But our compliments for that, and that has been one of the goals of this Committee, to find ways to make health care more affordable, especially to more small businesses around the country.

But thank you for having the courage to, and I hope you stick with it and I hope you are successful, and our compliments to you.

Mr. Bieron, if I could go to you next, some people have said that E-commerce is destroying Main Street retailers, but a recent study of historic Main Street downtowns found that they are having an economic renaissance with E-commerce, as you mentioned, attracting customers to them from around the world.

Would you comment a little bit on that again?

Mr.BRALEY. No, that is absolutely a trend that we think has emerged in the last sort of recent years. I mean, Internet time, people joke about Internet time. Things happen really quickly. Certainly when eBay was founded a dozen years ago, there was no honest thought on the business side that this would become in terms of sellers really a small business engine. Just, I mean, nobody went to eBay originally because they really wanted to work for small businesses.

That is how it has evolved. Likewise there was a time when it was seen that the Internet was a threat. Now, as you have said, increasingly your small Main Street business has a source of supply of goods to sell. In many cases their biggest inhibiting factor on the business side was traffic. It was buyers, and you know, when you are trying to sell on the Internet actually one of the big challenges is having that source of something to sell.

And so the small business that currently exists with the brick and mortar store, they already have that half of the equation taken care of. The Internet gives them the other half which, if they are effective in driving traffic, and eBay is a way to get traffic, you know, it kind of completes that cycle, and then suddenly you can do business.

And so, no, we absolutely believe that it is an engine that is going to keep Main Street small business alive trying to compete with the big box retailers who honestly over a number of decades from our perspective really are the competitive pressure that in many cases really hurts Main Street.

Mr.CHABOT. Thank you.

Mr. McClure, would you talk briefly about many of us would just go beyond an extension of the exemption on not taxing the Internet, the moratorium? We prefer to make it permanent. Could you talk a little bit about is there a cost to the uncertainty to business by not making it permanent as far as planning into the future?

Every couple of years you have got to wonder are they going to start taxing us or not. Could you discuss that briefly?

Mr.MCCLURE. Yes. We have seen that very clearly. I mean, our companies, and we represent a great number of infrastructure companies, not just large companies, but very small rural companies, but they are independent small businesses, and they have to lay out the money, and they have to go to the investment markets to get it. Uncertainty raises the cost of that money.

Uncertainty makes that money less available. Just as uncertainty in the marketplace right now makes it more difficult to buy a home, to get the loan to buy a home or a new car, we are looking at that on a much grander scale. We are talking about a trillion dollars.

So any time you inject uncertainty into the marketplace, you are going to raise the cost of that capital, make it more difficult to get and make it more difficult to achieve that goal.

But let's look even beyond that, sir. Let's look at simply what we want as a national policy. If we sit here today and say we must as a national priority have broadband to every American family, to every school child who needs to do homework, to every senior citizen who needs it for health monitoring services; if we want to put broadband, high speed, affordable broadband to every corner of America, then how does it make sense to say we are going to start down this road and then erect a large barrier called $35 billion a year in new taxes on that service?

It does not make any sense. If this is, in fact, the nation's priority and if we're to believe virtually everyone in this Congress, it is a priority and it does not make sense not to make this a permanent tax moratorium.

We are not talking about E-commerce taxes. We are not talking about the larger universe of taxes. We are talking about a narrowly scripted tax that helps us to meet our national goal of affordable broadband to every American. That is how it makes sense, sir.

Mr.CHABOT. Thank you.

Madam Chair, in the interest of time, I will let other members and I will yield back, too.

ChairwomanVELÁZQUEZ. Thank you.

Mr. Braley.

Mr.BRALEY. Thank you.

Mr. Keating, let me start with you. I made a reference earlier in my opening statement to the impact that the Internet has had in rural communities and rural small businesses. One of the best examples of that from my district is a business that creates high end lighting fixtures that move from the Bay area in California to a remote community in Clayton County, Iowa, Elkader, and is now marketing its products all over the globe, and there have been a number of successful spinoff businesses that have arisen from that as this community has embraced the opportunities that come from Internet sales and marketing.

One of them is a product called Little Miss Match that takes mismatched socks and mittens and sells them to young girls who are a target audience that really embraces that product.

But one of the things that I am interested in from you is getting some sense of the geographic scope of the tax policies we are talking about today based upon what you hear from your members and how these tax policies impact them in places other than our large urban shopping areas.

Mr.KEATING. Well, I think you are hitting a critical area as a topic in geography because small business owners in those rural areas are probably the ones that have been empowered the most, right? Because when you're in an urban setting, you know, a dense suburban area, you have got a market at hand if you are a Mom

and Pop shop. But now the rural businesses are the ones that are able to literally reach around the globe.

So it is a very exciting thing. Geography becomes less and less of an issue. So it has been very exciting to look at how those businesses have been empowered.

Now, what does it mean in terms of tax policy and how they are going to be hurt? They are going to be hurt the most because they are the ones that have to be able to reach out. They are relying on this high tech, wonderful computer world we live in, the Internet, to reach all of those customers, more so perhaps than those companies in those other areas.

So it is most critical to them, and I think it is important for members of Congress to keep in mind and, quite frankly, elected officials at the state and local level, to keep in mind the impact of taxation. Because of the Internet and because of these technologies, businesses can become a lot more mobile.

I happen to live in New York. You do not have to live in New York City or work in New York City anymore to make a nice living or to start up a business and succeed. You can be in South Dakota. You can be in Wyoming. You can be in Iowa.

So people in all of those states, all of those people that are representing businesses have to keep in mind what is going to happen if this moratorium goes away. What are the dangers to small businesses in general, but also, what is going to be the impact on the state if we decide to go ahead and do something on the Internet access tax front.

Mr.BRALEY. Mr. McClure, following up on that idea, one of the things that I think really transformed business relationships in this country was the advent of E-mail communications in addition to Internet shopping opportunities, and how it enabled people, customers, suppliers, vendors to develop personal relationships with people they never actually had met in their lives.

And one of the astounding things that arose out of that is when you would meet someone in person for the first time. You had the sense that you were lifelong friends because you had been communicating with them for so long.

Could you talk a little bit about some of the human side of the explosion and the growth of Internet sales and how that has impacted the future of the business that we have been talking about here today that will be also impacted by this tax policy?

Mr.MCCLURE. Yes, I can. And just for the record, I would like to note, sir, that I am a Hawkeye class of '73. So let me salute you.

[Laughter.]

Mr.MCCLURE. I think we focus sometimes—it had to be said.

Mr.BRALEY. Let me say I am very proud of the fact that both the Minority Staff Counsel and the Majority Staff Counsel, like me, are University of Iowa College of Law graduates. So we really are pleased to have you here today.

Mr.MCCLURE. Thank you very much.

So often we focus on E-commerce, and we talk about the miracle of electronic commerce without looking at the miracle of communication, and you have hit it immensely there. Imagine. I raised three children, and I can tell you first hand that without Instant Messaging their social lives would have been totally destroyed.

[Laughter.]

Mr.MCCLURE. If you look today to the miracle that is communication, it has happened largely because of the Internet. Cell phones today are moving toward the Internet. Why? Because that is the preferred method of communication. It has enabled me to communicate with people around the world. My closest friends now are in places like Germany and Australia. That simply would not have happened when we were growing up.

It is an amazing technology, and if we move there into the social networking sites, if we look at even what it has done to jobs, your ability to find a job, your ability to find a mate, it is an amazing process. Communication is the miracle of the Internet, not just commerce.

ChairwomanVELÁZQUEZ. Time has expired.

Mr. Fortenberry.

Mr.FORTENBERRY. Thank you, Madam Chair, for holding this important hearing.

Mr. McClure, I want to give you a friendly warning. When you tout your educational credentials as being from the University of Iowa, you are also talking to Representatives who have constituents that go to the University of Nebraska, but we want to minimize tensions in this room.

[Laughter.]

Mr.FORTENBERRY. All on the same page in trying to think about creative ways to expand the opportunities that have exploded on the Internet.

So in fun, I appreciate your comments and your willingness to be here.

I did want to ask you a direct question as well though. You had made a comment that 87 percent of Internet taxation goes toward compliance. I think we need to go back to probably what was an original point stated. We need to be careful. We are talking about two things, two issues here. One is taxation on access to the Internet and taxation on Internet commerce. They are separate entities, taxation on E-commerce.

I assumed you were talking about E-commerce sales tax collections as 80 percent of that collection activity going to compliance. Was I correct in that understanding?

Mr.MCCLURE. That is correct, and I am sorry if there is some confusion over that, but the data on sales tax collection is the best data that we have in terms of percentage of compliance. For small businesses, 87 percent of the cost of collecting and remitting taxes is tied up in the sheer compliance cost according to Ernst & Young.

Since we cannot effectively measure the impact of collecting and remitting taxes on Internet access or multiple and discriminatory taxes on E-commerce, this is the best proxy that we have. And the point I was attempting to make is that the level of compliance cost is disproportionate. For a large company that already engages in multi-state activities and may have nexus in multiple states, the cost is lower because they have already absorbed and provided for that cost. Small businesses have not.

So disproportionately this impacts small businesses to a much greater degree than it would a large or even medium size company. And that was the point I was trying to make.

Mr.CHABOT. Would the gentleman from Nebraska yield for just one moment?

Mr.FORTENBERRY. Certainly.

Mr.CHABOT. If I could just ask for a clarification, did I hear you say that if you collected the tax, 87 percent of what you got, 87 percent was in just collecting it?

Mr.MCCLURE. Yes, sir.

Mr.CHABOT. The cost was in collecting it. So you only get 13 percent basically that the governments can use. The other 87 percent was just for compliance?

Mr.MCCLURE. No, sir, because the 87 percent is absorbed by the company. The amount of taxes they have to remit do not change, but the cost of collecting and remitting those taxes does.

Mr.CHABOT. All right. Thank you.

I thank the gentleman for yielding and I yield back.

Mr.FORTENBERRY. Yes. I think that is an important point. Let's just give a simple example. If a small company has interstate commerce of $1,000, let's assume sales tax costs are five percent in the particular state. That would be $50. Therefore, I am going to get stuck doing some math here. That is a bad example.

[Laughter.]

Mr.FORTENBERRY. Let me back out, but the major portion—

Mr.MCCLURE. Perhaps I can clarify by saying suppose that the company is required to collect $5,000 in taxes and remit that $5,000.

Mr.FORTENBERRY. Right.

Mr.MCCLURE. For a small company, you can add another 87 percent to that $5,000 on top of that for the cost of compliance.

Mr.FORTENBERRY. I see. I understand. I think it is an excellent point to be made.

How would you define small business in the parameters in which you are talking about?

Mr.MCCLURE. Generally, and there are lots of definitions, as you know, but generally when we look at it from an accounting standpoint, and I have some credentials there as well, we are looking at companies of fewer than 200 employees with revenues somewhere less than $10 million per year.

Mr.FORTENBERRY. Well, I think this is a significant finding from this hearing, Madam Chair, about the high cost of compliance and particularly I would assume elasticity of demand is significant on Internet sales as well, as it was suggested on Internet access. So that is an important point to be made.

I would end on this quick story. I have a grain farmer in my district, a small, traditional grain farmer struggling to make ends meet; converted the business model into an Internet sales of specialized hay products for the pet market. Now that struggling grain farm has I think it is about 50 employees; just received one of the major business awards of the year; provides very good jobs in a rural county of Nebraska.

This is the power of what we are talking about here. So I think I appreciate all of your input and your involvement in this industry that has, again, resulted in so much economic good for small businesses as well as people who work for small businesses throughout the country.

ChairwomanVELÁZQUEZ. Time has expired.

Ms. Hirono.

Ms.HIRONO. Thank you, Madam Chair.

Mr. Keating, you represent a nationwide organization, and I am wondering whether you have or you are aware of any national demographic data on the people who are engaging in Internet selling. In other words, is there any data on the number of women, the minorities, in rural areas? Do you have that kind of information or are aware of where that kind of information is available?

Mr.KEATING. Actually, I do not have it at my fingertips, but we do talk about that on our Web site, and I can get the information to you. But SBECouncil.org, we have all sorts of analysis on those types of things.

And, you know, as a broad brush statement, it is just across the board. I mean the numbers are, you know, every imaginable business. I mean, our group, you know, we range from the consultant in the home based business, the one person shop, to manufacturing firms, to high tech and everything in between, and all of them one way or another are dramatically impacted by obviously the Internet, but they are out there selling things on the Internet, and it cuts across all demographics: women businesses.

The growth, of course, as you know, in women businesses right now is far outdistancing males and in various ethnic groups the growth rates are dramatic right now. It is a very exciting time in terms of the growth of small business, and all of them are working with or through or on the Internet, and we can certainly get you some more information on that in terms of some exact numbers.

Ms.HIRONO. Thank you very much.

One question for Mr. McClure. In your testimony you noted that if the moratorium is not extended, states and localities will take more than $35 billion per year out of the economy.

How did you get that number?

Mr.MCCLURE. Well, that is actually a number generated by the states and municipalities based on what they claim they are losing each year because of this act. So we can assume that would be the minimum level that they would begin with.

I would also point out the 30 percent figure that we use because it tends to be higher than some of the estimates of other groups which have said that Internet taxation would only be a modest five percent or maybe as much as 14 percent.

If you look at telecommunications taxes nationwide, you need only look to Richmond, Virginia, where local taxes on telecommunications are at 30 percent, and they are not alone. It is in many districts nationwide.

Our fear is that by the time you heap on multiple indiscriminate taxes, 30 percent is going to be a very low figure.

Ms.HIRONO. Thank you.

And of course, Hawaii is one of the states that has an exemption from this moratorium, and I am sure I will be very unpopular if we get rid of that exemption. However, I am all for supporting small businesses.

Thank you, Madam Chair.

ChairwomanVELÁZQUEZ. Ms. Fallin.

Ms.FALLIN. Thank you, Madam Chairman.

I am still looking over all of the testimony here. I had a couple of questions.

I enjoyed the conversation with the gentleman on the 87 percent of the cost, the taxes and the cost of doing business if taxes were to be collected over the Internet, and I was thinking about my daughter. Is it Bieron? Is that how you pronounce your name?

Mr.BRALEY. Bieron.

Ms.FALLIN. Bieron. She buys nothing but things over the Internet. She just loves the Internet, and she called me up yesterday here in Washington, and she said, "Mom, I bought a dress for $5.00. It is absolutely gorgeous."

I said, "Well, great. It saves Mommy money."

But I was thinking about, you k now, if she were to ever want to sell things on the Internet as a small business person and she hopes to kind of have a small business some day and about the collection, and by the way, I am a co-sponsor on this legislation. That is where I am at. But what would someone like a young person who is wanting to start up a company, and if the moratorium was not passed to be made permanent? What would it do to a young person or small business owner that is trying to start up a new company as far as having to learn how to collect the taxes and the time commitment and the financial accounting practices? What would it do to that small business owner?

Mr.BIERON. Sure, and I do think it is important that we distinguish Internet access taxes. There are actually three kinds of taxes we are sort of talking about here. There is Internet access taxes which are going to show up on your Internet bill. So the bigger the small business, the more connectivity, the more band width they are paying for; usually the more money they are paying for their Internet services. Therefore, they are going to have that bill.

Then there is the kinds of multiple and discriminatory taxes, which in particular in the digital world would be a real threat. If you want to deliver movies over the Internet compared to somebody who has a Blockbuster video store, you know, the idea that potentially a state or locality without the current prohibition could put a 20 percent tax on a downloaded video where it is maybe a seven percent sales tax in a store, that is a discriminatory kind of Internet tax.

And then the third category would be the currently with the Quill decision, the issue of sales tax collection is based on nexus so that your daughter's small business would be required to collect and remit sales taxes to the State of Oklahoma when she sells to a customer in Oklahoma, but if she sells it across the country, she would not have the burden of having to know what's the sales tax rate when she sells to San Jose, California. Who do I send those taxes to?

So the compliance cost that Mr. McClure was referring to, I think would be the idea that in the sales tax world adding more jurisdictions where you have to collect and remit is extraordinarily expensive for small business.

Actually the question was how do you define a small business. Actually the Small Business Administration of which this Committee knows something about, one of the things they do is define how big small businesses are for all of the various programs that

are over there, and in the area of E-commerce, E-commerce retailers are considered small businesses up until the point where they have sales of $21 million, which I often say seems like a lot unless you are competing with Wal-Mart. then 21 million is not a lot.

But changing the Quill decision and requiring a small business to start to collect and remit taxes for the 15,000 sales tax jurisdictions that are in America we think would be actually so expensive that it is inconceivable that small businesses could do it without immediately having to simply outsource the service to technology providers, but that would be the burden, is that if she wanted to sell when she gets to the point where she is buying and selling dresses just because that's what she likes to do, having to know what the sales tax is everywhere when it is a sales tax holiday, you know, all of those things, and then where you send all of those taxes to, and then keep all of those records for all of those jurisdictions because you could be audited by any one of them in that world is extraordinarily difficult to even conceive of.

Ms.FALLIN. Thank you. I appreciate that answer.

Can I ask one quick question of Mr. Keating?

ChairwomanVELÁZQUEZ. Sure.

Ms.FALLIN. I think it was under your testimony that you list the other countries in the world that have better access to broadband, and you show the United States ranked towards the bottom. I was just curious if any of those other countries have a tax on the Internet on sales.

Mr.KEATING. I do not know the answer to that actually. I will certainly look into it for you though.

Ms.FALLIN. I am just curious because I notice there are a lot of countries that have better access than we do, but I just do not know where they are as far as tax and the Internet.

Mr.KEATING. And just on your earlier question very quickly is two things to keep in mind now is that when you have any tax, a new tax that comes in, if it applies to individuals and businesses, businesses tend to get hit harder, and the harder they get hit, the small guys get it even worse compared to the big guys.

And then there is the regulatory aspect. When you look at the numbers, however you want to shake it out, per employee cost, regulations, particularly on the tax front, hit smaller firms much, much harder than it does the big guys.

So the big guys most likely are going to be able to weather these things much better than the smaller firms.

ChairwomanVELÁZQUEZ. Time has expired.

Ms.FALLIN. Thank you.

ChairwomanVELÁZQUEZ. Mr. Ellsworth.

Mr.ELLSWORTH. Thank you, Madam Chairwoman.

Mr. Bieron, first I want to thank your company for their position on the reselling of the banned toys that I heard about just in the last few days. Thank you for that position. I hope they continue that, and I hope other companies follow that lead.

Mr. Dewey, thank you. The reason I asked for this Committee as a third committee was for people like you back in Indiana. I think Indiana beat Iowa last week, didn't they, by the way?

[Laughter.]

Mr.ELLSWORTH. Oh, when Indiana wins a football game, we brag a lot.

My question is pretty short really. One thing I have found since coming to Congress other than you sell bottle head dollars and sometime in eight short months, you feel like a bottle head doll up here, but there is always the other side of the coin. If we had another hearing tomorrow or who is going to come into my office next week and watches this and takes notes and says, "That is all bunk. There is another side to this story"?

It sounds like you have pretty broad support in this room, but who is going to come in and tell me the other side of this story? Who is the enemy here?

And as far as you want to go and maybe Mr. Keating and Mr. McClure are the appropriate people.

Mr.KEATING. Well, I think you are going to hear from a lot of state and local officials and the folks that represent them. The National Governors Association, I believe, is not too thrilled with this idea. The American Federation of State, County, and Municipal Employees are not too keen on it. So I think it is pretty predictable that is who you are going to see, and they are going to talk a lot about needing more revenue for vital services and the sky is falling and so on.

But, again, I think if you take a look at the actual numbers, as I said, those are just some broad numbers that I cited, but the growth in revenue has been tremendous at the state and local level, and the key is there just like at the federal level. If you have a growing economy, a growing, healthy economy, you are going to have more government revenue. That is one of the benefits.

So then the question becomes does taxing the Internet make sense to keep the economy growing, and I would say no.

Mr.MCCLURE. A more important factor will be who you will not hear from tomorrow. You will not hear from consumers who want those taxes. You will not hear from economists. You will not hear from consumer advocates. You will not hear about anyone who has a responsibility for the growth of broadband, and that includes most state legislatures.

You are going to be talking to people who are looking to raise their revenues, and honestly, they cannot give you a good justification for why they need the revenues, which is why it is now being repositioned and repackage is somehow a state's right. You see, it doesn't have to do with the taxes. It has to do with rights. Very clearly, it is not a constitutional right to tax interstate commerce. So the important thing to remember is you are not going to hear about the people who care about deploying broadband to every American family.

Mr.ELLSWORTH. What about industry that is going to say this gives you the unfair advantage or we always hear about leveling the playing field, and you hear that a lot. Is there any industry that is going to come in and say you are getting unfair advantage here?

Mr.MCCLURE. I do not think so, sir, and I do not want to muddy the waters again by talking about taxing electronic commerce because this bill is not about that, but if you go back to the Quill decision, one of the things that the Supreme Court was very clear

about is that taxes are a payment for service. Those brick and mortar companies receive direct services. They have received roads that go to their premises. They receive police protection and fire protection, and taxes are the way they pay for those services.

When you have an electronic company that has no nexus, when it does not have that presence, it does not receive those services and, therefore, there is no justification for the payment of taxes simply because you want more money.

Mr.ELLSWORTH. Thank you, Madam Chairwoman. I yield back.

ChairwomanVELÁZQUEZ. Thank you.

Mr. Gohmert.

Mr.GOHMERT. Thank you, Madam Chair.

And I do appreciate you all being here, your testimony. After my alma mater A&M lost to Miami, I was heard to say that I think too many schools are spending too much of their emphasis on athletics and need to get back to academics, but after last weekend, I think we have got the right proportion.

[Laughter.]

Mr.GOHMERT. But the 87 percent cost of compliance intrigues me because the way it was described by Mr. Bieron I can see that just being a nightmare trying to figure out which city, which state gets which part of which taxes, and then you could have disputes over who should be getting that, and understand I am signed on. I do not want to see the Internet taxed, but when I hear a number like that, it does seem to be a little extreme because I think what the proponents are talking about is some scheme where, you know, you send taxes into a central repository and maybe even let them figure out which states get what, and it does not look like it would be an 87 percent cost of compliance to do that, does it, Mr. McClure?

Mr.MCCLURE. It would be lovely if there were such a process, sir, but the fact is that process does not exist. It is all black box stuff. Give us the right to tax and somehow we will figure out a way to do it fairly.

They have been asked for more than a decade to figure out how to do it fairly, and then Congress would consider it. They have yet to come before you and say, "This is our plan to do it fairly." It is all black box stuff.

And let me point out we are not—

Mr.GOHMERT. Well, now, I need to dispel one thought that you have got, and that is linking the United States government and fairness. I have just been here three years, and I have not seen that linkage yet. We are still looking, and especially when it comes to taxes.

But we do hear states, local government. We need revenue. More and more is going across the Internet. It is going to kill us locally. I have not exactly worked out how since the economy is booming and the federal and state and local governments, most of them, are receiving more money than in history, how this terrible intrusion called the Internet has been such an adverse effect.

I understand conceptually we have got more goods being sold across the Internet than ever before, and so perhaps some of those are not being sold locally with local sales tax that would have been, but it is an interesting dynamic.

Do you have any explanations as to how more commerce is going across the Internet and yet most states and local governments are receiving more revenue than ever? Anybody?

Mr.BIERON. Just to provide some data behind that, the Department of Commerce's, and quarterly they update with the retail numbers, and they break out Internet commerce. So at eBay we would say, you know, Internet commerce is growing rapidly, but traditional retail is so immense that it is almost hard to fathom the difference.

Right now E-commerce in the U.S. is estimated at just under three and a half percent of total retail. So last year that was about $125 billion of E-commerce retail, compared to over three trillion in total retail.

So in some ways, I mean, again, at eBay we would say that this growth is great. Obviously it is our business to empower small businesses to do that, and so we see the future being very bright, but at the same time we should not lose perspective on the fact that traditional storefront retail is trillions and trillions of dollars.

And so honestly with that growing, traditional retail last year grew approximately four percent. Online retail grew about 20 percent, but the baseline for the traditional retail was so huge that actually sales tax revenues for the state reached record levels.

So when they come in and talk about the Internet, you know, threatening their economics, their revenue stream tremendously, I mean, maybe in 50 years you would set these growth rates, that would be the case, but today some of that really is kind of crying wolf.

Mr.KEATING. If I could, and again, I think it goes back to understanding the phenomenon of economic growth and what that means for government revenues overall. You are not just talking about sales tax revenues. You are talking about income tax revenues. All the other taxes that are paid because of or due to an expanding economy, so you have all of those benefits that come into the equation.

What you will hear though is a very selective definition of E-commerce is increasing by X amount or Internet access is increasing by X amount, and if we could get our hands on that, you know, that equals X number of dollars.

But it does not necessarily mean that government should or needs to get their hands on those additional revenues.

Mr.GOHMERT. Thank you.

My time has expired.

ChairwomanVELÁZQUEZ. Your time has expired.

Mr.GOHMERT. Thank you, Madam Chairwoman.

ChairwomanVELÁZQUEZ. Mr. Lieberman, I would like to address one other question to you. Cable companies have obviously made efforts to expand access to broadband Internet and other technologies. You stated that many of your members are small and medium size cable companies that are serving smaller communities, particularly in rural areas.

What challenges will your members face in its attempt to provide expanded services if the moratorium was not extended? And in particular, how do you believe it may affect efforts in broadband deployment?

Mr.LIEBERMAN. Thank you.

You are correct. Our operators do serve smaller markets in rural areas, and the reality is that many of our members are already offering broadband services in those areas. It is truly the smallest of our operators that are still looking for ways to deploy those services because of their size and the difficulties in terms of the costs and spreading those costs over the number of customers served.

ChairwomanVELÁZQUEZ. Would you also talk about how this broadband deployment has benefited small businesses?

Mr.LIEBERMAN. Oh, absolutely. Well, mostly our operators from their beginning have been video providers, offering services to consumers in homes. Certainly when they have upgraded their systems to offer broadband services there has been new opportunities in order to offer these services to businesses, and that has been a growth area for many of our members, and they have been able to gain a lot of business consumers in their communities.

ChairwomanVELÁZQUEZ. Mr. Lieberman, the Internet access taxes are taxes on the service providers. What is the likelihood that cable providers such as yourself would be forced to pass those taxes onto consumers and small businesses much like television and fun taxes?

Mr.LIEBERMAN. The unfortunate reality is that they would likely be passed along to the consumer. Our operators are running their businesses on small margins and do not have the capacity to absorb those costs and would have to pass it along.

ChairwomanVELÁZQUEZ. Mr. Chabot, do you have any other questions?

Mr.CHABOT. Just briefly, and again, I was going to go to Mr. Lieberman also. I would not want him to feel left out in this, but there have been a lot of questions that have not necessarily been related to the cable industry.

But let me ask one other thing, Mr. Lieberman, if I can, and that has to do with the rates. Could you tell me what the mindset of your consumer is right now relative to cable rates and going along with the question that the Chairwoman asked about how they would feel about rates being increased if this tax, the exemption, did not continue? So, in other words, taxes went up.

How would the general public, in your view, feel about that?

Mr.LIEBERMAN. They certainly would have a lot of frustration. Obviously in the video sector for us, costs are increasing. We constantly hear about it from our consumers, about those cost increases, and question why. Certainly, on the Internet side, we rolled out services that we believe are affordable and increasing costs on those through taxes, we certainly would hear back from our customers why.

And just to give an example of a small cable operator, there is one in western Texas that serves 1,700 video subscribers and 300 broadband services. The average income in two of the counties, the household income is 30,000. For two of the other counties, it is 22,000.

There is demand for Internet and broadband Internet, but there is also the difficulty in providing it at an affordable cost. An Internet tax would have a serious impact on the ability for people in

these communities to be able to purchase that, and that is a concern for a lot of our operators in those type areas.

Mr.CHABOT. Thank you.

And, Mr. Keating, our colleague from Indiana who is not with us at the present time, but mentioned who would be on the other side of this because we actually have a panel here which is actually somewhat unusual here, but then the Chairwoman and I are completely together on this. So I guess we could have drug a governor in here or somebody, but that is what happened.

You know, when I co-sponsored this bill, in fact, I think I was one of the original co-sponsors of the legislation some years ago, the first phone call I got was from my governor. We were county commissioners together, and he went to the governorship and I came up here. He was also the lowest rated governor of all the governors over the last couple of years, too. I will not tell you what state I am from so that you cannot figure out who he is from, and he is really a very good guy and I like him a lot even though, you know, he has had some real rough times over the last couple of years.

But in any event, that was the first call I got from him, was how devastating this would be, you know, to my people in Cincinnati and all of the people of Ohio if we put on this extension and did not allow them to tax and how important that was to let them get this tax, et cetera.

So that is one group, is local elected officials and governors, et cetera, and the other group that we got some criticism from was the so-called, you know, brick and mortar, some of the stores perhaps that say it is an unfair advantage. And you have already touched on this, but could you briefly, Mr. Keating, again deflate that argument as to why this is a bad thing from the point of view of local elected officials and brick and mortar folks?

Mr.KEATING. Absolutely. You know, I think the first thing is to look at the actual numbers, is to see what has been going on in regards to the revenue front for state and local governments. You know, I think the exceptional person that holds office at that level is going to say, "You know what? Revenues are rolling in pretty good. So we are okay."

So you have got to look at the numbers. The numbers show that revenues have been increasing at a dramatic rate, about better than three times the rate of inflation. So that is number one.

Number two is, again, the issue of allowing small businesses to flourish through the Internet, having the foresight to say, okay, if we impose this tax what is it going to mean to the economy overall. What is it going to mean to these small businesses? Do we want to really take those steps and cause these problems where, again, a lot of the big guys are going to be able to handle this in terms of the tax itself and all of the red tape and everything that goes along with the regulatory aspects of the tax, but the small guys are not going to be able to handle this.

And then finally, the other part of the equation is do the small guys matter. Well, of course they do, and when you go back and look at all of the aspects of where an innovation comes from, where does job growth come from, and any year it is 60 to 80 percent of net new jobs come from small businesses. They are employing a lit-

tle more than half of the private sector work force. So do you recall want to go down this path and open up the door to these taxes that are going to do such damage to small businesses and entrepreneurs?

Mr.CHABOT. Thank you.

And then finally, one quick question. You mentioned in your written statement the 2001 and 2003 tax cuts that were passed here in Congress that the President signed into law. In your opinion, how important are these tax cuts to economic growth that we have seen and how important is it that we make those tax cuts permanent?

Mr.KEATING. Oh, huge. A huge issue. I mean, when you look at when the 2003 tax cut went through, the middle of 2003, it was no mere coincidence that at that point the economy started to pick up. Private sector investment picked up dramatically.

Keep in mind that most businesses, better than 90 percent of businesses pay the personal income tax rather than the corporate income tax. So it hits the bottom line of small businesses. If you want, access to capital is critical. So lower capital gains tax is very important.

All of those things are in that package. The estate tax, all of those things impact small businesses in a big way, and we need to make that permanent, as we need to make the Internet tax moratorium permanent, to help them and to get that certainty into the equation.

Mr.CHABOT. Thank you very much, and I want to thank the entire panel for their testimony. I thought it was very good.

ChairwomanVELÁZQUEZ. Thank you.

And I, too, want to thank all of you for your willingness to be here, to discuss an issue that is important, and it has been demonstrated that it has an impact on small businesses. Given the fact that the Small Business Committee has expanded jurisdiction over issues that affect small businesses, we intend to be engaged in this issue.

I ask unanimous consent that members have five legislative days to enter statements and supporting materials into the record, and with that this hearing is adjourned.

[Whereupon, at 11:40 a.m., the Committee meeting was adjourned.]

STATEMENT
Of the Honorable Nydia M. Velazquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: "The Internet Tax Moratorium"
Wednesday, October 3, 2007, 10 a.m.

I now call this hearing to order on the "The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing the Moratorium to Expire."

With the advent of the Internet, electronic commerce has been a driving force for economic growth in our country. Small businesses in particular have played a vital role in the digital economy. For many entrepreneurs, an Internet connection can serve as an avenue to start a new business or grow an existing one.

Today's hearing will focus on the Internet Tax Moratorium and its pending expiration. Since 1998, federal law has prohibited taxes on Internet access and has ensured parity between online and offline sales.

As we have witnessed over the past 15 years, the Internet has proven to be the great leveling field in American business today, permitting small firms with fewer resources to compete. In a recent survey of small business owners, 83% reported that the Internet had improved communications about their company. Additionally, over sixty percent stated that the Internet has opened up new markets for their businesses.

The current moratorium has played an important role in encouraging Internet sales for small businesses. However, with many states and local governments under pressure to find additional sources of revenue – some have advocated against the extension.

Today's discussion will examine the impact the expiration would have on small businesses competing in a technology driven economy. It is fairly clear that the moratorium has been a catalyst for the growth in e-commerce among smaller enterprises. The current non-discriminatory tax treatment has allowed many small businesses to use the Internet as another medium to expand.

While the overall degree of impact may be argued, the growth by small businesses in Internet commerce cannot. E-bay alone reports that approximately 10 million sellers make their full-time living from home based businesses.

Layering unpredictable taxes, many of which would be regressive in nature, could place small businesses at a disadvantage. Studies have shown that a hike in these taxes could hit the smallest e-retailers the hardest. It could also add significant paperwork burdens for small businesses that simply don't have the resources to meet new requirements.

While some may discount the impact of higher access fees, it is important to consider the overall price sensitivity of the market. Assuming that Internet access is taxed similarly to wireless communications, small businesses could see an upwards of a 15-30% increase in their Internet bill. For some, that could make the difference in the decision whether to market products and services online.

The moratorium was created as an economic policy to allow small businesses to compete. The prohibition has made the Internet a gateway for entrepreneurship regardless of race, income, or neighborhood. Many of the most commonly known Internet companies in the world, including E-bay, Amazon, and Google, started as very small Internet companies. We should be careful to make sure we are not preventing the next Google.

At a time when small businesses face many obstacles, we should be advancing policies that help small firms compete in our new digital economy. With the moratorium set to expire in a little less than a month, it is important for the Committee to fully understand the implications if Congress fails to act.

I appreciate the witnesses coming here to discuss this important issue and look forward to your testimony. I would now yield to the Ranking Member, Mr. Chabot for his opening statement.

Opening Statement

Hearing Name	The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing Moratorium to Expire
Committee	Full Committee
Date	10/3/2007

Opening Statement of Ranking Member Chabot

Good morning. I thank each of you for being here today as we examine the negative effects of allowing the Internet tax moratorium to expire. I also want to thank you, Madame Chair, for holding this very important hearing.

Since 1998, Congress has ensured that Internet access is not subject to either state and local taxes or multiple and discriminatory taxes on Internet commerce, regardless of the technology consumers use to access the Internet. If the moratorium is allowed to lapse, American taxpayers could be exposed to countless new and onerous taxes from states and municipalities simply for accessing the Internet.

The Internet has changed the way we communicate, learn, and do business—all for the better. Since the moratorium was first adopted, tremendous investment, growth and innovation in the scope and use of the Internet has occurred. By preventing unnecessary taxation of the Internet, Congress fostered growth in productivity and innovation and widened public access to information.

While Americans use the Internet for a myriad of reasons, e-commerce has particularly flourished and continues to grow at an exceptional rate. In 2006 alone, online retail sales exceeded $100 billion, increasing 24 percent over 2005. This is especially important to small businesses. An Internet connection opens doors to the rest of the world. No longer must an entrepreneur focus his or her marketing strategies to just their neighborhood. With the advent of the Internet, the world is their neighborhood, and quite literally, the sky is the limit.

Although this expansion is impressive, there is still more that we must do to ensure equal access among all Americans. Internet usage still lags behind in rural and lower income areas and many experts have reported that the United States has fallen from 4th to around 16th in broadband deployment since 2001. In order to reverse this trend, we must keep Internet access costs at a minimum. Prohibiting unnecessary taxes will help accomplish this goal.

In addition to making the moratorium permanent, I believe we ought to re-examine the grandfather clause as well. I have been and still am concerned about this provision because I believe it rewarded a handful of State tax administrators who rushed to tax the Internet access.

With America's small businesses already strapped with high legal costs, regulatory burdens, onerous taxation, high energy prices and rising health care costs, they should not be slapped with new taxes on Internet access. Simply put, allowing the moratorium to expire would result in a tax increase on small businesses and American families. Permanently extending the moratorium would allow the unfettered growth of the Internet and e-commerce to continue. Tax cuts, innovation, and the free market are the surest formula for economic growth and prosperity. The surest way to stifle achievement, progress, and growth is to involve the government.

The evolution of the Internet has directly contributed to the growth of the U.S. economy—as Internet usage has grown, so has e-commerce. Every day, millions of Americans are online making many varieties of transactions, from buying products to managing their banking accounts.

By making permanent the Internet tax moratorium, Congress can assure that this vital tool remains a key driver of economic growth.

Again, thank you Madame Chair for calling this hearing on such a critical and timely issue. I look forward to hearing the testimony. I yield back.

October 3, 2007

Congressman Bruce Braley Opening Statement

Hearing on "The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing Moratorium to Expire."

Thank you Madame Chairwoman, and thank you for holding this hearing.

Today we are here to talk about an important issue, the Internet tax moratorium. The moratorium, which began in 1998, is set to expire on November 1st. That is why it is essential we take a look at this issue now.

The expansion of electronic commerce in this country can be directly related to affordable internet access and tax parity between online and offline sales. The internet has become a huge economic development tool, especially for small businesses. If we make this moratorium permanent, this will allow these small businesses to know what costs they will be dealing with as they attempt to start a new venture or expand upon an existing one.

And many of these small businesses will go on to become large internet companies that have the potential to employ thousands of Americans and add billions to our economy. E-Bay, one of the companies represented by our panel today, is certainly a prime example of this.

We as a government have a responsibility to promote a permanent tax moratorium on the internet when there is still so much untapped potential in the electronic commerce industry. That is why I am a proud cosponsor of H.R. 743, the *Permanent Internet Tax Freedom Act*.

In addition to helping small businesses grow, a permanent internet tax moratorium will help ensure that all Americans can afford internet access. It will also promote further broadband deployment in rural areas, such as in many parts of my District in Iowa, which still lack affordable access to high-speed internet.

If taxes on internet access are raised, the number of consumers who are able to afford it will go down. If the internet were taxed similarly to wireless communications, many consumers and small businesses would see upwards of a 17% increase in their internet bill. For small companies operating on thin profit margins, this increase could make the difference between their success or failure.

I look forward to hearing from our witnesses today and hearing how an extension of the tax moratorium would affect each of them. It is essential we act promptly on legislation to extend the internet tax moratorium before the current legislation expires on November 1st. Our nation's small businesses are counting on us.

Thank you Madame Chairwoman, and thank you to the witnesses for coming in today.

The Testimony of
Mr. Brian Bieron
Senior Director of Federal Government Relations
eBay Inc.

Before the House Small Business Committee
October 3, 2007

Madame Chairwoman, Ranking Member Chabot and members of the Committee,

My name is Brian Bieron, and I am the Senior Director for Federal Government Relations at eBay Inc. I would like to thank the committee for giving eBay this opportunity to discuss the importance of the Internet Access Tax Moratorium to small businesses.

At eBay, we believe that the Internet is a good thing. We believe that it is a remarkable, revolutionary, empowering technology. Of particular importance to this Committee should be the fact that the Internet is a powerful force supporting American small business success in the global 21st Century economy.

Today, small retailers across America are using eBay to reach a global customer base. Some are primarily eBay-based businesses, many use eBay as well as other Internet channels to reach Internet-enabled consumers. Finally, more and more traditional brick-and-mortar retailers are augmenting their storefront business with Internet sales. All in all, we estimate that over 720,000 small businesses use eBay as a primary or secondary marketing channel.

The evolution of brick-and-mortar small businesses adopting the Internet is a particularly interesting story. There was a time when many traditional small business retailers seemed threatened, or maybe awed, by the Internet. It was a gee-whiz technology that might make sense for Silicon Valley, but what did it have to do with the small retailer trying to stay afloat on Main Street in towns and small cities across America?

The reality of the past decade is that the Internet has proven to be a remarkable tool for small businesses.

In the retail industry, small entrepreneurs face a world of global behemoths. Those multi-billion dollar businesses source product globally and use technology to relentlessly increase efficiency and drive down prices. Mega retailers have been relentlessly pressuring small business retailers for decades. In a word, the Internet has been a lifeline for many of those small businesses.

The Internet allows a small retailer to tap into the global economy in two key ways. First, the small business can use the Internet, the ultimate open and level-playing field, to reach a global customer base. For example, approximately 15 percent of the sales of US

small businesses using eBay are cross-border sales. Yes, eBay is enabling a small business export success story. This holds tremendous hope for US small business growth.

Second, the Internet increasingly allows small retail businesses to source product globally. The mega retailer is global, buying from factories in every country of the world and selling from stores in every corner of America. Now, the Internet allows the small retailer to likewise find the best products at the best prices anywhere in the world.

So, what does this all mean for your consideration of the Internet access tax moratorium? We believe that you should take up the mantle of Internet-enabled small businesses and call on your colleagues to extend the moratorium on access taxes, and multiple or discriminatory taxes on the Internet. Permanently.

By the way, along with learning quite a bit from our community about how small businesses use the Internet, we think we've also learned a little bit about how markets work. In fact, eBay has often been called the most perfect market. Our marketplace is super efficient, benefiting hundreds of millions of consumers, and hundreds of thousands of small businesses across the globe.

We know that when you raise prices you reduce demand. Anybody, or any study, that tries to make the case that even if you raise prices you will not reduce demand, is highly suspect on its face. If taxes on Internet access go up, fewer small businesses will use the Internet. More importantly, fewer consumers will use the Internet. And for the small businesses using the Internet, that means fewer sales and less opportunity to compete with the mega retailers. Bad news.

So, in conclusion, we support maintaining the core regulatory principles that have unpinned the Internet as a small business success story. On the tax front, this includes policies such as the tax-free treatment of Internet access, and the Quill decision limiting tax burdens to the local and state government where an Internet-entrepreneur resides. The open, non-discriminatory nature of the Internet, and the current Internet-liability regime are equally important.

This committee should make a strong statement for small business by calling on the House Leadership to rapidly bring a permanent access tax moratorium to the House floor.

Thank you and I am happy to answer questions.

Brett Dewey
Testimony before the House Small Business Committee Subcommittee on Taxation
"The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing Moratorium to Expire"
October 3, 2007

Chairwoman Velázquez, Ranking Member Chabot, Members of the Committee, good morning. Thank you for inviting me to be here today, it is quite an honor. My name is Brett Dewey and I own a small online company called WickedCoolStuff.com that sells toys, t-shirts and other small gifts that we think are wicked cool. I hope my testimony helps explain the importance of extending the internet tax moratorium.

Unlike a lot of the people you may hear from I'm not part of a formal coalition or an experienced insider. In fact, this is the first time I've done more than vote or write a letter to my Congressman. I got here using frequent flier miles accumulated on my company credit card and I'm sleeping on a friend's sofa. And I just have to say that this room seems a lot smaller on C-SPAN.

WickedCoolStuff.com is a real-live mom and pop operation. My wife Cynthia and I run the company out of a warehouse in the San Fernando Valley region of Los Angeles. Our son, Alex, is almost three and primarily helps out by playing hide-and-seek amongst the shelves and boxes.

We have five full-time permanent employees. As the Christmas holiday approaches we'll probably add eight full-time seasonal staff to help with the rush. Cynthia and I provide health insurance to our full-time employees after they have been with us for several months; we would like to do more but cannot afford to. We try to be good employers and good community members; we believe that makes good business and is the right thing to do. The internet tax moratorium has been in place since before we started WickedCoolStuff.com eight years ago. Letting it expire now would be a new tax on our small business, one we cannot afford.

Just like every other business, ours has had its ups and downs. Right now, like many small online retailers, we're down. We are taking steps to improve sales and I'm optimistic that we're headed for another up, but a new tax right now would be devastating. At the moment we're down looking up, but a new tax could have us down looking out.

Continued

Brett Dewey Testimony, Cont.
Page 2 of 2

We started WickedCoolStuff.com eight years ago in our spare bedroom. When the boxes took over the living room, den, garage, and were creeping into the kitchen we decided it was time to get a warehouse. Since then we have grown to as many seven full-time permanent employees and sales of over $1.3 million at our peak down to our current level of five employees and projected sales of less than $1 million. In our best year Cynthia and I paid ourselves about $60,000. This year we are unlikely to draw any salary at all, relying on savings and a home equity loan to make ends meet.

I have prepared a chart that is included in my written testimony to help explain the financial realities of a small company like ours, and why letting the internet tax moratorium expire now would be so devastating. These numbers are based on our experience, and while they might not withstand an IRS audit they give you a pretty good idea of what it costs to run a business like ours. The handout is for a hypothetical company called HypotheticalExamples.com, an online retailer that expects to sell $1 million of small plastic hypothetical examples this year.

Most of the company's income goes to buy wholesale goods, which cost about $500,000. Another $200,000 goes to shipping those goods from the wholesalers to the warehouse and then out to customers. $135,000 is for salaries – none of which goes to the owners. $17,200 goes for health insurance, $15,000 for payroll taxes, rent is $33,500, marketing is another $34,000, internet and ecommerce hosting is $19,000, another $9,950 goes to various local taxes and workmen's compensation, and $34,500 goes to utilities, book keeping, bank fees and insurance. That leaves just under $2,000 for the owners of HypotheticalExamples.com to share as a salary, which comes to roughly $17.50 a week each.

While this may sound like WickedCoolStuff.com, and the numbers are drawn from our experience, it is not our company – we are unlikely to do even this well this year. Cynthia and I are working hard to turn WickedCoolStuff.com around, and we are confident we can. We are actively are adding new features, new products, and we are trying new marketing. But letting the internet tax moratorium expire could derail those efforts and with it our company. Our options would be: lay off employees; stop providing the health insurance on which our employee's families rely; or close our doors.

A new tax now would be the equivalent of changing the rules in the middle of a game we're currently losing.

Thank you for again for inviting me here today, I hope that my testimony has been helpful. Typically I would give you all a WickedCoolStuff.com gift certificate or a Star Wars bobble head to show my appreciation for inviting me here, but I'm told that would violate ethics rules. Instead I encourage you all to visit WickedCoolStuff.com and purchase one for yourselves and your staff. We need all the help we can get.

I look forward to your questions.

Testimony of David P. McClure
Before the US House of Representatives
Committee on Small Business
October 3, 2007

Chairwoman Velazquez, and members of the Committee:

My name is David McClure, and I am president of the US Internet Industry Association, a trade association that for the past 15 years has served businesses engaged in Internet connectivity, online content and electronic commerce. Our members, the majority of which are small businesses, are concerned that without immediate action on the part of Congress they will be immediately subjected to multiple, discriminatory, retroactive and crippling taxes.

The impact of allowing the Internet Tax Non-Discrimination Act expire without extension would be felt specifically in three ways for small businesses:

- **An almost immediate loss of customers.** Internet connectivity is price elastic. That is, the higher the price the fewer people are interested in using it. Studies by Ernst & Young, but the University of Massachusetts and others have confirmed this elasticity, as does research by the Pew and Internet Life Project. If taxes are permitted that would raise the cost of basic Internet access by as much as 30 percent, the predominantly working families that are not on the Internet will not be able to afford to get there; and families that now have basic Internet access will no longer be able to afford it.

- **Loss of opportunities for survival and growth.** In today's economy, small businesses in America are able to compete globally due in part to our superior infrastructure – the Internet backbone, our rich diversity of broadband and the growing wireless networks spanning the far reaches of the nation. But the growth of this infrastructure depends on sustained and increasing levels of private investment – as much as $1 trillion between

2015 and now alone. But if the tax moratorium is not extended, states and localities will take more than $35 billion per year out of the economy. That's nearly 1/3 of the cost of national deployment of broadband that will be made unavailable for private investment – and that's not counting the additional costs of compliance.

- **The cost of compliance is a critical factor.** Remember that the current moratorium does not ban sales and use taxes. It bans multiple and discriminatory taxes – the type that target Internet transactions for higher taxes than their brick-and-mortar counterparts, and those that tax the same transactions in multiple ways. Ernst & Young has calculated that for companies selling nationally with collection responsibilities in 46 states, the compliance cost ranges from 14 percent of sales taxes collected for large retailers, to 48 percent for medium retailers and 87 percent for small retailers. The burden clearly would fall hardest on small businesses – those least able to staff and maintain large tax compliance and remittal departments.

The original Internet Tax Freedom Act was not, as some have retroactively suggested, an effort to give the states time to find better ways to tax the Internet. It was an alarmed and informed response to a significant pattern of abusive, punitive and destructive taxes passed by local authorities with little regard for how their actions would impact consumers, businesses, the economy or our national interests. It was Congress' way of putting an end to this tax abuse.

John Marshall, the US Supreme Court Justice who shaped much of our constitutional law, noted that "The power to tax involves the power to destroy; that the power to destroy may defeat…the power to create." There is no clearer example of how abuse of this power, and its negative impact on creativity, than the imposition of multiple, discriminatory and predatory taxes on America's small businesses.

BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS
TESTIMONY OF ROSS J. LIEBERMAN
VICE PRESIDENT OF GOVERNMENT AFFAIRS
AMERICAN CABLE ASSOCIATION
OCTOBER 3, 2007

Chairwoman Velazquez, Ranking Member Chabot, and members of the Committee, thank you for inviting me to testify on the Internet tax moratorium and how its potential expiration would impact small cable and broadband providers, and consumers across the country.

My name is Ross Lieberman, and I am Vice President of Government Affairs of the American Cable Association. ACA appreciates the chance to testify before this committee, which understands the unique challenges that face small businesses. In a telecommunications world that is becoming increasingly dominated by industry giants, ACA is the voice for nearly 1,100 small and medium-sized cable companies that serve more than 8 million subscribers in all 50 states. Our members range from family-run cable businesses serving a single community to multiple system operators that focus on smaller markets and rural areas. The average operator size is about 7,500 subscribers, but some of ACA's members serve fewer than 1,000 subscribers.

ACA members are key businesses in their communities. In addition to providing broadcast and cable programming, many of our members offer unique local programming, such as high school sporting events and religious services,

which is not available from national providers. They also offer advertising opportunities for small businesses. Most importantly for the purposes of this hearing, our members are rolling out high-speed Internet access, providing a broadband connection in their communities where no other company offers it.

The ACA supports continuing the Internet tax moratorium. At a time when the costs of running their businesses are increasing, small cable operators are deploying broadband services, despite the financial hurdles of offering such services in rural America. Congress can safeguard these investments and ensure high-speed Internet access remains affordable for consumers by passing legislation that prevents state and local governments from imposing taxes on this service.

Our members are offering broadband to their customers, in spite of the economic challenges typical of service providers in rural America. First, the cost to upgrade a cable-only system to provide Internet access is significant and more difficult to recoup for operators with a limited number of subscribers. Equipment costs for upgrades are often the same regardless of the number of customers that will be served. Therefore, developing a business model to pay for a piece of expensive equipment is very different for a system that has only 5,000 subscribers versus one that has a half-million. Second, the cost of maintaining a cable network is high when the distance among subscribers is great. A small

cable company might need an employee to travel an hour or more to make a service call to a subscriber's home. Finally, access to capital can be difficult. To pay for the necessary upgrades and maintenance costs, many of our members must turn to bankers on their local Main Streets, not financiers on Wall Street.

ACA members are deploying high-speed Internet service to meet consumer demand. Our members know that their customers want broadband, and they are finding ways to offer it at reasonable prices, knowing their customers are price sensitive. Therefore, any potential increase in cost, including an Internet access tax, would cause some consumers to not purchase this service.

Small cable operators are investing in, and moving to, offering broadband services at a time when the costs of running their business are increasing. The most significant concern of ACA members is the rising cost of cable and broadcast programming. Small cable operators who serve a limited number of subscribers have no leverage in negotiations with network broadcasters and national programmers who come to the table demanding that operators pay double, even triple, the fees previously paid.

Small cable operators are also troubled by existing regulations, and new ones placed upon them by the Federal Communications Commission in the last

year. On June 1, the Commission mandated that cable operators begin deploying digital set-top boxes with separable security to their subscribers, which cost significantly more than the integrated devices that were commonly offered by our members. Then, on September 11, the Commission adopted rules that force cable operators to carry some broadcast stations in both digital and analog formats which require operators to make costly upgrades to their systems. Neither regulation has an exemption for small operators. These costs are making it more difficult for our smallest members to remain viable and reinvest in affordable advanced services for their communities.

The ACA supports continuing the Internet tax moratorium, and our members urge Congress to pass legislation before the ban expires on November 1. Small cable operators have made significant investments to offer high-speed Internet services in their service areas, and they are concerned that an expiration of the moratorium could have an unfavorable impact on their businesses and communities.

Without the moratorium, state and local jurisdictions are likely to impose a patchwork of new taxes on American consumers and businesses, including those in smaller markets and rural areas, simply for acquiring a broadband connection. These taxes would increase prices and make broadband access less affordable for consumers.

New taxes on Internet access would be especially problematic if excessive state and local cable taxes were simply extended to broadband services. Most cable subscribers already pay franchise fees up to 5%. Imposing similar taxes on Internet access at these levels would discourage some consumers from signing up for the service. To tax a service that is neither fully deployed nor adopted seems to contradict Congressional intent to expand broadband coverage and penetration.

Our members, who live in the towns and rural areas they serve, also support the Internet tax moratorium because they know first hand how broadband access has improved their communities. It has made their towns a better place to live, work and raise a family. In addition to offering the service to consumers, some of our members provide broadband to hospitals and schools, enhancing their hometown's health care and education. They also offer service to their community's small businesses, allowing them to sell their goods and services throughout the country and the world. In some rural areas, cable operators also provide high-speed Internet access to their local government. At a time when the benefits of these services are coming to smaller markets and rural areas, our members believe government should continue to take a hands-off approach with respect to taxes.

Chairwoman and members of the Committee thank you again for the opportunity to testify on this topic of importance to small cable operators. We urge Congress to continue the Internet tax moratorium.

Testimony before the

Committee on Small Business
U.S. House of Representatives

The Honorable Nydia Velazquez, Chairwoman
The Honorable Steve Chabot, Ranking Member

Submitted by
Raymond J. Keating

Hearing Date: October 3, 2007

Chairwoman Velazquez, Rep. Chabot and members of the House Small Business Committee, thank you for holding this hearing on "The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing Moratorium to Expire."

My name is Raymond J. Keating, and I serve as chief economist for the Small Business & Entrepreneurship Council (SBE Council), which is a nationwide, nonpartisan, nonprofit small business advocacy organization. We work on a wide range of public policy issues that are important to entrepreneurs and small businesses.

That most certainly includes the current moratorium on Internet access, and multiple and discriminatory e-commerce taxes that has been in effect since Congress took action in 1998. As you know, this tax prohibition was extended in 2001 and again in 2004, and is scheduled to expire in November of this year. We strongly urge that this moratorium be made permanent.

Today, I would like to touch on four points regarding this issue.

The Economy

First is the economy. We are at one of those points where our economy could easily veer

off in almost any direction.

On the negative side are energy costs, housing and sub-prime lending problems, consumers being less confident, and some recent disappointing reports on retail sales and manufacturing production.

Among the positives are rising household net worth, increasing investment in nonresidential structures, solid exports, and good growth in real disposable income in recent months.

Then there are the mixed signals. For example, in the second quarter of 2007, real GDP growth was pretty good, but growth generally underperformed from late 2005 to early 2007. Similarly, real gross private domestic investment was up in the second quarter, but that was after declining during the three previous quarters. Finally, employment growth took a turn down in the latest month, but is up over the past year – in fact, up solidly over the past several years.

In this mix, there are real concerns over tax policy. For example, pro-growth aspects of the 2001 and 2003 tax relief measures are scheduled to expire over the next few years. Will these be extended or made permanent, or will all or part of these measures be allowed to expire, thereby inflicting a large tax increase on the economy?

Similarly, the possibility of states and localities inflicting tax increases on Internet access and e-commerce would loom as another potential problem if the current moratorium expires. Leaps ahead in computer, broadband and other telecommunications technologies have proven to be a tremendous boost for the economy. Taxing Internet access, and/or imposing discriminatory e-commerce taxes will only serve to restrain business and the economy.

Broadband Access

Second, higher taxes on Internet access would mean that the growth in broadband access would be restrained.

That would make a current competitive disadvantage for the U.S. even worse. Keep in mind a story from the August 9, 2007, *Wall Street Journal* ("Is High-Speed Internet Growth Slowing?") that showed broadband household penetration rates in the fourth quarter of 2006 among 25 nations. The U.S. came in last. (The following table reproduces this data, with the source being *The Wall Street Journal*, which acquired the information from Point Topic and WebsiteOptimization.com.)

Nation	Household Broadband Penetration (%)
South Korea	89.0
Monaco	82.9
Hong Kong	79.8
Iceland	75.7
Singapore	69.6
Netherlands	69.4
Denmark	69.3
Israel	69.0
Macau	68.8
Switzerland	66.5
Canada	63.0
Taiwan	61.4
Norway	59.7
Finland	59.5
Guernsey	57.4
France	55.5
Japan	55.1
Germany	53.2
Luxembourg	52.3
U.K.	52.3
Sweden	51.8
Belgium	51.7
Estonia	50.4
Australia	50.2
U.S.	50.1

Creating more tax uncertainty and opening the door to higher Internet taxes are not positive policy developments for investing in broadband networks.

Small Business

Third, obviously, is how this issue affects the small business community.

Small businesses will be hurt in various ways, including the taxes they pay for Internet access, reduced customers via the Internet, and their goods and services potentially facing multiple, punitive levels of taxation. Those are all significant negative threats to the bottom lines of small businesses across the nation.

Advancements in computer and telecommunications technologies have opened up tremendous markets and opportunities for entrepreneurs and small businesses. A permanent ban on Internet access and discriminatory e-commerce taxes would further solidify benefits for consumers and small businesses.

In a recent FoxNews.com article on this topic by SBE Council President Karen Kerrigan, a quote from Monica McGuire of the National Association of Manufacturers drove home the point simply and clearly: "New taxes on Internet access amounts to turning the information superhighway into a high-priced toll road."

Tolls on the information superhighway mean that small business commerce faces higher costs, and the possibility of getting stuck in the slow lane.

State and Local Government

Finally, I'd like to touch on state and local government revenue.

Many state and local government officials, and their representatives, do not like the idea of a permanent ban on Internet access taxes. They, unfortunately, view the Internet as a cash cow to be milked, rather than a source of economic opportunity for all.

They often try to argue that government would somehow be denied the necessary revenues to fund vital services. In reality, however, state and local governments have been rolling in the taxpayer dough. Consider that total revenues for state and local governments increased from $1.4 trillion in 1995 to $2.5 trillion in 2005 (latest U.S. Census Bureau data). That was a huge 78 percent jump, while inflation registered 22 percent over the same period. That included an increase in sales and gross receipts taxes from $237 billion to $383 billion, or a jump of 62 percent.

State and local revenues have been accelerating at some three times the rate of inflation. So, the notion that state and local governments need to extract even more money from taxpayers is very difficult to accept.

To the contrary, more revenue in the hands of government means fewer resources left in the private sector for consumption, investment and job creation.

If Congress wants to hamper the Internet, and related economic opportunities and growth, then clearly this Internet tax moratorium should be ended. But if they wish to see the full potential of the Internet realized, then the current tax moratorium should be made permanent.

Thank you, and I look forward to any questions you might have.

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