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NEWSLETTER

Internet Tax Freedom Act

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On October 21, 1998, President Clinton signed into law the Internet Tax Freedom Act (ITFA), the culmination of almost two years of efforts spearheaded by Senator Ron Wyden (D-OR) and Representative Chris Cox (R-CA). The ITFA seeks to head off the threat of multiple, conflicting, and discriminatory taxation of the Internet and electronic commerce conducted over its wires. The bill's sponsors identified more than 30,000 separate jurisdictions that could assert taxing authority over various aspects of Internet commerce in the absence of legislation. Consequently, Internet-based companies were concerned about both the potential cost of new taxes and the administrative costs and burdens of complying with such levies.

The Act contains four major provisions, the complex details of which will almost certainly be the subject of substantial debate and dispute. First, the Act imposes a moratorium from October 1, 1998 through October 21, 2001, on new state and local taxation of Internet access services. Internet access is defined as a capability for accessing "content, information, electronic mail, or other services offered over the Internet" and may include the proprietary offerings of online services such as AOL, but does not include telecommunications services. Notably, the moratorium does not affect existing taxes, so states that imposed taxes before the date of the Act may continue to tax the Internet and e-commerce. The Act also does not prevent universal service assessments under the Telecommunications Act of 1996, taxes imposed on the underlying telecommunications services used by Internet access providers, or taxes on other types of information services such as those of LEXIS-NEXIS that are not sold over the Internet, so long as those taxes satisfy traditional Constitutional nexus requirements. It also does not protect Internet providers of material deemed harmful to minors unless they take prescribed measures to restrict access by minors to such material. A further exclusion from the moratorium becomes effective six months after enactment for those Internet access providers who fail to provide their subscribers with screening software for adult materials.

Second, the ITFA imposes a similar moratorium on "multiple or discriminatory [state and local] taxes on electronic commerce." Again, existing state and local taxes are preserved and the same exceptions to the moratorium apply. Discriminatory taxes would generally include (1) taxes whose applicability is determined by reference to unique Internet-related characteristics, such as the ability to access a site on a remote seller's out-of-state computer server or the characterization of an Internet access provider as an agent of such remote seller, (2) taxes not also imposed on "transactions involving similar property, goods, services, or information accomplished through other means"; (3) taxes imposed at a different rate than on similar transactions or subject matter; and (4) taxes imposing a collection obligation on a different entity or person than in the case of similar transactions by other means. For example, sales taxes typically imposed on a seller of goods cannot be uniquely imposed on buyers of goods over the Internet.

Third, the Act establishes the Advisory Commission on Electronic Commerce. The Commission will be composed of nineteen members, including representatives from the Federal Government, state and local governments, and the electronic commerce industry—the latter to be appointed by the Majority and Minority Leaders in Congress. The Commission is to report back to Congress within eighteen months on the appropriateness of taxing the Internet, foreign barriers to electronic commerce, the impact of consumption taxes on electronic commerce generally, and the problems of inconsistent and discriminatory taxation of electronic commerce and other means of remote sales.

Fourth, the ITFA declares the sense of Congress that the Federal Government should not impose any new or discriminatory taxes on the Internet and Internet access services during the moratorium. It further calls on the President to seek international agreements to remove barriers to global electronic commerce, such as tariffs, quotas and other less obvious trade barriers. Such efforts, as well as the activities of the Commission over the next eighteen months and the inevitable litigation over the provisions of the ITFA itself, will undoubtedly have a major impact on the development of electronic commerce.