

# CALIFORNIA SENATE OFFICE OF RESEARCH

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## FEDERAL UPDATE

### INTERNET TAX MORATORIUM EXTENDED FOR THE SHORT TERM IN GOVERNMENT FUNDING MEASURE

In September 2014, Congress passed, and President Obama signed, a temporary extension of a federal moratorium on Internet access taxes as part of a short-term continuing resolution to fund the federal government. The ban, originally established under the Internet Tax Freedom Act in 1998, was set to expire on November 1, 2014, but has been extended through December 11, 2014.

Congress plans to work on an agreement for a longer-term extension of the ITFA moratorium during the post-election lame-duck session, and might consider combining it with controversial online sales-tax legislation.

#### INTERNET TAX FREEDOM ACT

The Internet Tax Freedom Act (ITFA), which was passed by Congress and signed by President Clinton in October 1998, originally placed a one-year moratorium on any specific taxation of the Internet. The Act specifically prohibited state and local governments from taxing Internet access and from imposing Internet-only taxes, such as bandwidth and e-mail taxes.

Since its enactment in 1998, Congress has extended the ITFA moratorium four times. Prior to the current continuing resolution, the most recent extension was under the Internet Tax Freedom Act Amendments Act of 2007, which extended the ITFA moratorium until November 1, 2014.

The original intent of ITFA was to protect the public from being taxed on information available over the Internet. The ITFA emerged during a time when the Internet was experiencing rapid growth and officials believed that a halt on any taxes was necessary to foster that growth.

ITFA includes a grandfather clause, which allows any state that imposed taxes on Internet access before October 1, 1998, to continue doing so; those states are Connecticut, Iowa, New Mexico, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Texas, and Wisconsin.

The ITFA moratorium does not apply to sales tax. Supreme Court decisions in 1967 and 1992 held that a state can require out-of-state companies to charge sales tax only if they have a physical presence in the state, such as a store or warehouse. Legally the tax is still due (as a use tax) directly to the out-of-state retailer. Yet few people comply with the use-tax requirements, because either they do not know about them or they avoid payment on their tax returns.

California already is collecting this online sales tax and is ahead of many states in this effort. This is due to the passage of Assembly Bill 155 (Calderon, Chapter 313, Statutes of 2011), which redefined a retailer “engaged in business in this state” by expanding which retailers are responsible for collecting and remitting the sales tax. Since the passage of the bill, Amazon.com, the largest online retailer, has been collecting and remitting the sales tax.

## WHAT WILL CONGRESS DO?

The online sales-tax issue now has become part of the debate as Congress considers legislative action on the ITFA Internet tax ban. Both the Senate and House have introduced bills that address the ITFA moratorium. In July the House passed H.R. 3086, which permanently extends the ITFA moratorium on state and local taxation of Internet access, but allows the grandfathering protections for certain pre-1998 taxes to expire. The House then reapproved this bill as part of an omnibus jobs bill (H.R. 4) in September 2014.

In the Senate, S.2609 was introduced in July 2014. It pairs a 10-year ITFA extension with the Marketplace Fairness Act (MFA) of 2013, which passed the Senate but stalled in the House last year. The MFA authorizes states to collect sales taxes from out-of-state retailers who sell and ship products to consumers within their borders. However, states are granted this authority only after they have simplified their sales tax laws. S.1431,

which would make the moratorium permanent and allow the grandfathering protections to sunset, also was introduced in the last 12 months, but the bill has not proceeded yet to a committee markup.

Supporters for renewing the ban argue the Internet has helped drive economic growth and that taxing it would impede development and obstruct more widespread Internet access. Conversely, opponents of the ban argue that Congress should let states and local governments decide whether to levy taxes on Internet access and contend it does not make sense to continue to treat the Internet as a nascent industry in need of special protection.

The upcoming lame-duck session gives Congress the opportunity to work on an agreement for a longer-term extension of the ITFA moratorium. It is not clear yet what action Congress will take before December 11, 2014, although it is possible Congress will approve another short-term extension of the ITFA ban. If this happens, it would push the issue into 2015, allowing the new Congress to reconsider the moratorium.

**Written by Meg Svoboda.** The California Senate Office of Research is a nonpartisan office charged with serving the research needs of the California State Senate and assisting Senate members and committees with the development of effective public policy. The office was established by the Senate Rules Committee in 1969. For more information, please visit <http://sor.senate.ca.gov> or call (916) 651-1500.

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