Mr. Chairman and members of the committee, I am Michael Leavitt, Governor of Utah. I am here today not only as a member of the Advisory Commission on Electronic Commerce, but also on behalf of the National Governors' Association. Thank you very much for the courtesy that's been extended to me this morning.

No other innovation — no other way of doing business — has revolutionized our nation's economy faster than the Internet. It took generations for the Industrial Revolution to play out around the world. The Internet Revolution has unfolded before our eyes, in less than a decade. The speed of this change has been astounding. In the Industrial Age, as change took place, governments were able to react accordingly. In the Internet Age, today's innovation is tomorrow's standard. Government must act on Internet time.

Congress, as well as state and local governments, need to function in this new economy by facilitating its continued expansion. In one area, we have an opportunity, if unencumbered by the federal government, to do just that— to create a radically simplified and streamlined sales tax system that eliminates the burdens from our current horse and buggy system.

And I believe we came close in the commission to achieving a balanced approach, a fair approach with a level playing field. I remain convinced that the states are already moving rapidly in the right direction, and I remain

convinced that the high tech industry, the nation's retailers, and states and local governments could reach consensus amongst ourselves.

Any thoughtful discussion on e-commerce must include the following key issues:

1. The proper relationship between the federal government and the states on issues of taxation, and which levels of government ought to bear the responsibility for determining and financing the needs of their citizens and businesses;
2. The necessity of keeping tax policy neutral so that neither traditional retailers nor remote sellers (catalog, Internet, or similar enterprises) are given an advantage based on tax policy;
3. The need to stop erosion of essential revenue streams that support education and other key public services at the local level.

Governors are vitally concerned about any action that could negatively affect the vast majority of retailers — most of them small businesses, by the way — as well as their employees in our states, and erode the revenue source most important to the provision of education, public safety, and transportation services to the American people and businesses.

Extending the Moratorium

On behalf of the National Governors' Association, we oppose S. 2255, which would extend the provisions of the Internet Tax Freedom Act (ITFA) for an additional five years. Since the current moratorium does not expire until October of 2001, there is no compelling need to act at this time. This is

particularly true since the technology is changing rapidly and creates substantial uncertainty with regard to unintended consequences. A rush to judgment on this matter could be detrimental to the Internet and electronic commerce industry, to Main Street America, as well as to state and local governments and all of our citizens who rely on government services every day.

Some of the technology issues that create uncertainty with respect to impacts include:

- Bundled services;
- Discriminatory Tax Definition; and
- Internet Telephony.

These issues have little or nothing to do with the sales tax collection issue that has dominated debate on extension of the ITFA. They are, instead, the result of the rapid pace of technological change and developments since the ITFA was originally enacted. We believe it is important to the Internet industry as well as state and local governments that you address these issues as part of any extension of the ITFA. Failure to address them is likely to mean that the ITFA does not meet the expectations of Congress.

Future of the Sales Tax

The Advisory Commission report very directly raises the issue of the future of the sales tax in our country—the single most important source of revenue in America for public education, and which level of government ought to be responsible for determining and meeting the education, public safety,

transportation, and infrastructure needs of our citizens. The central issue between the states and federal government as it relates to e-commerce is *not* about new taxes on the Internet, but rather **how** the states will collect taxes already on the books, and whether states will remain sovereign in their right to collect those taxes.

In Utah and other states, we strongly oppose any **new** taxes on the Internet. We should not seek to enrich our state or federal coffers with new taxes just because of new technology and new methods of delivering goods.

There is no more fundamental responsibility for any of us elected to office than to that of representing our respective constituents and taxpayers. The concept of reciprocal immunity is an inherent part of our federal system, consistent with the basic sovereignty states retain under the 10th amendment to the constitution. For decades the states have had the authority to enact and modify sales tax laws and their complement use tax laws. Use tax laws have been effectively enforced for decades as it relates to business purchases.

The ACEC report asking Congress to impose unfounded mandates on states and local governments in excess of $30 billion annually through the preemption of existing taxes and creation of special privileges for certain kinds of companies through changes in state and local income, business activity, property, and sales and use taxes simply boggles any concept of our appropriate responsibilities to our respective citizens.

Is it possible that the federal government will override long-standing state policies in each of these areas that vary so dynamically from one state to the next? Once successful in this regard, will we see additional actions of the federal government? Will the federal government declare that income taxes can no longer be applied to the software engineers who build the websites involved? Will dot.com firms' warehouses be exempted from property taxes by action of the federal government?

Such an action would clearly violate the sovereignty of the states to enact and enforce sales and use taxes.

Imagine where that slippery slope leads in the years ahead -- congressional tax cuts imposed by eliminating state taxes! The taste of enacting tax cuts that don't reduce federal revenue could, of course, easily prove to be addictive. What about the elimination of state use tax on equipment necessary to reduce environmental emissions? Why not override states authority to tax diesel fuel that is used to transport goods across state lines? How about an end to income taxes for teachers? Or firemen? The opportunity for mischief is unlimited.

Only with state action to efficiently collect existing taxes will our traditional main-street retailers compete with the new world of e-commerce on a level playing field, and will our funding base for critical services be preserved for the years to come.

There is no question that the federal government has the right to regulate interstate commerce. But it would be virtually unprecedented for the federal

government to stomp on the most basic rights of the citizens and taxpayers of each and every state by determining how they may or may not raise revenues.

Creating a Level Playing Field

Any action taken by this committee should guarantee assistance towards achieving a streamlined sales tax system for the 21st century, a level playing field for all businesses, and no special privileges. In the face of the impending transformation of retail shopping, government tax policy must remain neutral. It is not the time to have government tilt competitive forces in favor of either traditional retailers or emerging electronic retailers. Unfortunately, without the states effective enforcement of our current laws -- and with the passage of proposals like that proposed by the Commission -- such government-sponsored special privileges will result.

We nineteen members of the Advisory Commission on Electronic Commerce (ACEC) gathered research, hearing and reviewing testimony from interested parties, sifting through proposals and debating varying perspectives; all in an attempt to form the basis of a balanced recommendation that addresses the most pressing issues raised by all parties and therefore could garner the requisite support of the Commission necessary to make a formal recommendation to Congress. We did not succeed.

Throughout the process some broadly held general views emerged and deserve to be articulated. They are the core concepts upon which any federal policies should be based.

Clearly our main task was intended to be the issue of the collection of taxes on remote sales over the Internet. We encountered a great degree of confusion about the current state of play in this area. The current rules for remote sales tax collection are guided primarily by the set of interpretations and practices emanating from the U.S. Supreme Court *Quill* decision, which essentially said that remote sellers are not responsible for collecting sales taxes for taxing jurisdictions where they do not have physical nexus. We have lived with this construct for decades and it has guided the tax policy of direct merchants and catalogue sellers for years. The reality is that sales taxes apply to electronic commerce conducted over the Internet and any seller that has nexus with a taxing jurisdiction is required to collect and remit such taxes today.

So why the current great debate? Today there is a view that the world is largely made up of electronic commerce companies and traditional brick and mortar companies. Inevitably, however, somewhere down the road, in 3, 5 or 10 years, take your pick, commerce will be intertwined with the cyber space and physical worlds will merge and interact to meet the increasing demands of consumers. “Bricks and mortar” retailers will pour millions into their online shopping offerings as they morph into “clicks and mortar” retailers. Clients will browse at home and order direct or head down to the store to “feel the fabric” or “swing the golf club”. Remote sellers will have contracts with local providers (who may or may not be legally affiliated entities) to provide service or accept returns.

In a world like this, if remote sales over the Internet are taxed differently than intra state sales we will have a system based upon a tangle of legal maneuvering that will create separations between local merchant and their Internet counterparts and a playing field that will be viewed as inherently unfair. Such unfairness, if left to fester, will bring contempt and non-compliance. It is hard to argue with the need for an enormous simplification of state and local sales taxes that can pave the way toward a level playing field that does not discriminate between methods of access.

In reality, of course, taxes on remote sales are already due. They are called use taxes and the obligation falls on the consumers to calculate and pay them. While they exist in most states, with respect to individual consumers they are collected more by exception than by the rule. So while any new system that implements a way to collect remote sales taxes would not increase the theoretical taxes on the books of government, it would undoubtedly lead to increased revenues collected. This raises its own issues.

I am pleased to report to you this morning that we, the states, have already achieved substantial progress in moving to radically simplify state and local sales taxes. For those of you that remember the efforts of former President Reagan, Senator Packwood, and Rep. Rostenkowski; you can well understand and appreciate the challenge we have undertaken. I can report to you that substantial progress was made as 26 States gathered in a cooperative effort in Denver, Colorado on March 30-31, 2000, to continue discussions focusing on the implementation of a revolutionary streamlined sales and use tax system. The *Streamlined Sales Tax System Project* is a comprehensive undertaking in direct response to the widespread call for

simplifying the sales tax. The States have enthusiastically embraced this unique opportunity to attain the fundamental simplification measures needed to maintain a viable sales tax system.

The States embarked on this mission in September 1999, by initiating discussions to develop and implement a simplified sales tax system. Two subsequent meetings were held prior to this most recent Denver meeting and continuing discussions are being conducted to resolve integrating the design elements of the new system. It is anticipated that a pilot project of the new system will be in place in Fall 2000.

Work Groups were established and charged with addressing a multitude of issues essential to successfully implementing the new system. The Work Groups are:

- Paying for the System, Technology, Audit, and Privacy Issues;
- Sourcing and Other Simplification Issues;
- Tax Rate, Registration, Returns, and Other Remittances; and
- Tax Base and Exemption Processing.

Several key issues received attention from the Work Groups, including:

- Ensuring that the use of technology does not breach the basic tenets of consumer privacy while simultaneously establishing a new benchmark of security measures designed to preserve the integrity of transactions;

- Developing straight-forward sourcing rules that can be easily implemented and adapted to an electronic environment;

- Implementing the use of existing technology that provides for the accurate mapping of tax rates to the appropriate taxing jurisdiction;

- Consideration of one local use tax rate for remote sellers and exploration of the available technology that will facilitate the administration of multiple tax rates; and

- Drafting uniform definitions, standardizing exemption processing procedures for use- and entity-based exemptions, and arranging for the use of a product coding mechanism that will provide a bridge between the tax base and the use of technology.

The Project States seek the input of both public and private sector groups, in addition to those companies and individuals willing to provide technical assistance to the Work Groups. A public comment period will be provided at each Project Meeting during which interested parties may comment on the Project's design initiatives and accompanying issues with the Project States.

Electronic commerce is growing exponentially and only if we start the process today of developing a tax system that contemplates the burdens the new economy will place on our existing structures will we be prepared to face the challenge.

The burden and responsibility of reform lies with the state and local governments. Clearly, any tax system must not disproportionately burden remote sellers. However, if a system can be established that equates the burden of inter- and intra-state sellers, a level playing field could exist. Finally, in designing a process to produce this system, we, as Commissioners, recognized that while there is a national interest in creating an environment that fosters growth of electronic commerce and ensuring any taxing system does not unduly burden interstate commerce, we also recognize the need to be mindful of the sovereignty of state and local officials in setting policies for their electorate.

Closing

Last week, Congress sent the President the Airport Investment and Reform Act for the 21st Century. That legislation is a tribute to you, Mr. Chairman, and the members of this committee. It is another important step to deal with not only critical safety issues, but also expanding the nation's ability to compete globally in this new economy.

The new legislation provides for an increase in taxes on the Internet. Not a single member of the House or Senate offered an amendment to exempt airline tickets purchased over the Internet from this tax increase. I believe we all understand how self-defeating such an amendment or policy would have been. It would have been terribly imbalanced. It would have sanctioned a double standard. And it most certainly would have led to significant erosion of the very funds this committee has made such a leadership effort to ensure are available to meet the nation's needs.

Let us be clear. No Governor is looking to tax the Internet, any more than any Senator is trying to impose a special, discriminatory tax on the Internet.

The states' sales and use taxes are existing taxes, not new taxes.

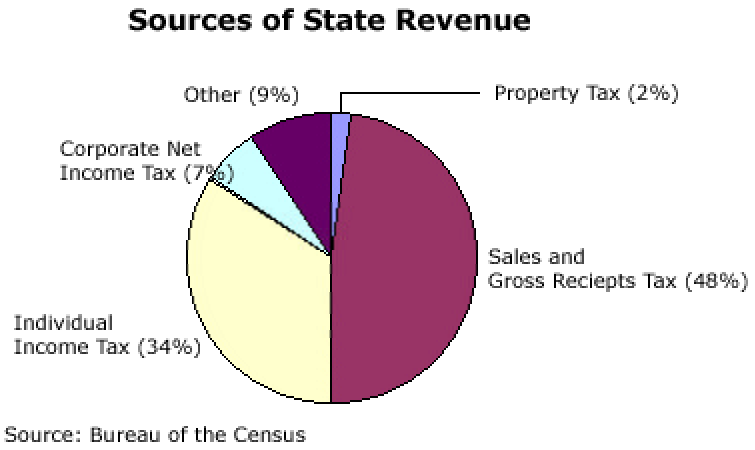
All we are asking is to keep the right we now have as a state to determine our own revenue policies under the laws the people of our state have adopted and we are elected to implement. Most of these sales and use taxes have been in place for at least 50 years.

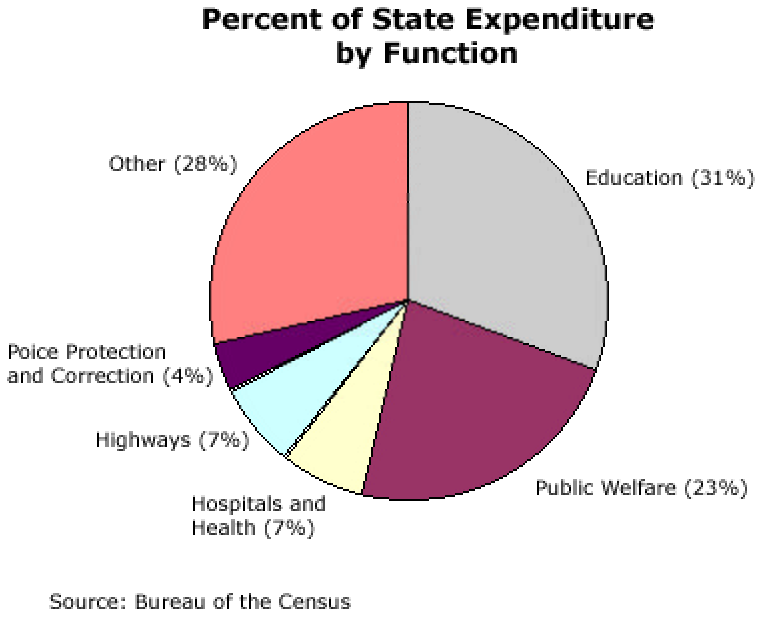
The largest revenue collections in the nation, even in the income tax states, are through state sales taxes. If Congress overrides states' tax policies by cutting our tax base, it will fundamentally upset both the states' and the nation's capacity to provide critical services to the people. The sales and use tax revenues belong to people and taxpayers of the states, not the federal government.

Finally, if we gravitate towards a tax system that creates a specific loophole for retailers that use the Internet, we risk creation of a federal policy that favors Internet vendors at the expense of Main Street stores and home-town merchants. We cannot adopt a tax policy in America that assists in harming traditional Main Street retailers.

Thank you for the opportunity you've given me to testify, Mr. Chairman.

Facts and Figures



States rely heavily on sales taxes to provide essential public services.

Facts and Figures