To: Tom Kahl

From: BF

THE PRESIDENT HAS SEEN
2-17-98

THE WHITE HOUSE
WASHINGTON
February 17, 1998

What's the answer to the Governors argument that we're now giving preference to L.L. Bean etc. — BC

MR. PRESIDENT:

T e attached memo from Gene Sperling, Mickey Ibarra and L rry Summers seeks your approval of a plan to take a more a tive posture on pending "electronic commerce" legislation. Without such support, the bill will likely die.

B ckground. The Internet Tax Freedom Act provides for a s dy process (including a Commission that you would a point) to develop recommendations for permitting e commerce to develop free of various state and local taxes. L st summer, Larry Summers testified in favor of the bill's g als and principles, but stopped short of endorsing it. The hi-t ch industry strongly supports the bill and Big 7 state and l cal groups (NGA, Conf. of Mayors, et al) oppose it. Earlier th is month, we proposed to the Big 7 that we work jointly on a b ll to address their concerns; they declined hoping they can k l the bill but want to keep talking with us.

O ptions. Two are presented, but there is no support among y ur advisors for the second. **Option A** recommends that the A dministration actively support the bill while continuing to s licit state and local views. *Pros:* opportunity to take credit f an anti-tax initiative beneficial to e-commerce; good public p licy for developing technology. *Cons*: Big 7 groups won't be h ppy, but will likely have to work with us as the bill p ogresses. In the end, only a veto will satisfy them. **Option B** is to continue supporting the goals of the bill without endorsing it but this strategy could kill the bill at this point.

J. hn *Podesta* and *Larry Stein* also support Option A.

___ Agree with Option A ___ Disagree ✓ Discuss

copied
Sperling
Ibarra
Summers
COS

Phil Caplan

F PRESIDENT HAS SEEN
2-17-98

THE WHITE HOUSE

WASHINGTON

'98 FEB 10 PM12:41

February 6, 1998

MEMOF NDUM FOR THE PRESIDENT

From: Gene Sperling GBS
Director, National Economic Council

Mickey Ibarra MI
Director, Intergovernmental Affairs

Lawrence H. Summers
Deputy Secretary of the Treasury

Re: Internet Tax Freedom Act (Cox-Wyden Legislation)

ACTIO FORCING EVENT

Congre is currently considering legislation (The Internet Tax Freedom Act, S. 442, H. 1054) introduced by Sen or Ron Wyden (D- OR) and Congressman Chris Cox (R- CA) to impose a moratorium on new or discrim atory state taxation of the Internet. The legislation provides for a study process to develop policy com nendations and is aimed at permitting electronic commerce to develop free of distortionary taxes ir posed by myriad jurisdictions. It is based on principles set forth in a Treasury policy paper, in the Jul , 1997 *Framework for Global Electronic Commerce* and in your Presidential Memorandum on electro ic co nmerce and is consistent with the position we have taken in international discussions.

Indust , not surprisingly, strongly supports the bill. Earlier this year, seven CEOs belonging to the Comp er Systems Policy Project, including Lou Gerstner of IBM, Lew Platt of Hewlett Packard and Lars N berg of NCR met with Secretary Rubin and Deputy Secretary Summers to urge full support.

State a l local groups such as the National Governors' Association, the US Conference of Mayors, NACC the National League of Cities as well as elected officials, however, strongly oppose the bill as usurpi g their ability to tax (though officials from high tech states such as Governors Wilson, Pataki and Celluc i support it.) Opponents have been slow to identify specific problems that might be fixed but cite lost sa s tax revenues if on-line sales cut into store sales that would generate taxes. They are concerned that w ile consumers are liable for taxes on mail-order sales, those taxes are rarely collected. State and local oups have said that the legislation "will lead to Main Street stores and small businesses ... across Amer a being forced to close due to the discriminatory impact of a sales tax levied only on retail stores, not th ir Internet competitors." In view of the federalism issue, last summer, Deputy Secretary Summers testifi d in favor of the bill's goals and principles but stopped short of endorsing it. Earlier this month, he propo d to the Big Seven state and local organizations that we work jointly on a bill that addresses their conc ns. They declined the offer while suggesting that we continue to talk. The Big Seven rejected the offer ecause they believe that they can continue to delay or kill the legislation, and are not motivated to work wit us until it is absolutely necessary.

On Nove nber 4, 1997, the Senate Commerce Committee reported out a bill. We understand that the Senate w ll wait for the House. Our active support is likely to help the bill and satisfy high tech propone ts while withholding support would partially satisfy state and local groups. Your guidance is sought c whether to take a more active position in support of the bill and therefore take credit for its passage r continue to maintain a low profile. A strong announcement of support early this session would p obably carry the most weight. IGA would prefer that we wait until mid-March, to avoid needless y antagonizing the Big Seven groups, who will be having meetings in February and early March.

OPTIO S

A. ctively support the legislation while soliciting state and local views in order to address any laws and legitimate concerns

This option will give us the opportunity to take credit for an anti-tax initiative that will be eneficial to the development of electronic commerce. From an economic point of view, reventing new taxes on a network that provides so many public benefits is good policy. The Sena e version has been improved to where Treasury's Office of Tax Policy now feels we can supp rt it, though some technical and substantive problems remain. This option will initially increase pressure from state and local opponents. However, as the legislation moves forward, oppc nents are likely to increasingly value our offer to use our offices to address their remaining concerns.

B. Con inue current posture (support goals and principles without endorsing legislation)

This option while frustrating high tech proponents would initially do more to satisfy state and local concerns and might lead to the bill's failing to pass. However, if the bill passes in its current form, anything short of a veto will still upset state and local opponents. If we take a lower profile, we will also have less influence to improve the bill.

RECC MMENDATION: Your economic and political advisors (Treasury, Commerce, NEC, IGA, OMB, and I Magaziner) recommend Option A. They believe this legislation will foster electronic commerce whicl is emerging as an important engine of growth while preserving our ability to address the legitimate conce ns of state and local governments. Withholding support may cause the legislation to fail, or if it passe anyway, subject us to strong pressure to veto a bill that we believe merits support.

__ Agreed   __ Disagreed   __ Let's Discuss

BAC GROUND AND ANALYSIS

The ntern t Tax Freedom Act would permit states to continue to collect existing, non-discriminatory taxe but imposes a moratorium on new or discriminatory ones and calls for a study process. Both bills call r you to appoint a commission representing the states, industry and the Administration, which will then issue recommendations which you may submit to Congress. The current Senate version of the bill ends the moratorium in approximately five years on January 1, 2004, which we think is appropriate.

The Administration's Actions So Far

Treasury first set forth the principle of tax neutrality for the Internet at the international level in its paper, *Selected Tax Policy Implications of Global Electronic Commerce*, released in November 1996. That goal was adopted by the sponsors of this legislation.

Deputy Secretary of the Treasury Summers testified last summer in favor of the goals and principles of the legislation but, at that early stage, stopped short of endorsing it. In his testimony, he set forth three guiding principles: first, that commercial activities conducted by means of the Internet should not be subjected to new or discriminatory taxes; second, that the Internet should not become a tax haven; and third, that we should be highly sensitive to concerns about federalism. In short, we supported technology neutral, non-discriminatory, taxation of electronic commerce that preserved the state and local tax base. The goal of tax neutrality was then incorporated in the July 1, 1997 paper, *A Framework for Global Electronic Commerce* and included in your July 1, 1997 Presidential Memorandum on electronic commerce. We have adhered to this principle in international and domestic tax policy discussions.

Efforts to Address State and Local Concerns

With the exception of officials in high tech states such as Governors Pataki, Wilson and Cellucci, most state and local officials oppose the legislation on the grounds that it inappropriately restricts their right to tax. They are particularly concerned that rapid growth in electronic commerce will come at the expense of store sales and, if treated like mail order sales for tax purposes, will cut into sales tax revenues. In fact the bill is silent on whether neutrality means neutrality with store sales where merchants must collect "sales tax" or neutrality with mail order sales where consumers owe "use tax" but merchants are not required to collect them. Nor does it address the thorny issues of "nexus" or where the sale takes place for tax purposes.

As a practical matter, states will face the problem of how to collect tax on out-of-state Internet sales whether the bill passes or not. The bill, as written, neither worsens nor solves their problem. Attempting to solve it would probably mean addressing the complex issue of mail order taxation. Recently, a proposed deal between the Direct Marketing Association and several large states on the mail order issue fell apart after strong negative reaction from mail order customers.

Since legislation was introduced, Treasury officials have met with the Multi-state Tax Commission, the Big Seven group of state and local organizations representing elected officials, and others to address specific concerns. While state officials generally expressed more interest in killing the bill than in identifying specific problems with the language of the bill, Treasury did communicate specific suggestions we received, as well as our own concerns, to drafters who incorporated most of them in the Senate bill. In January, Deputy Secretary Summers made an offer to representatives of the Big Seven state and local organizations to work jointly on a bill addressing the states' larger remaining concerns. However, after some consideration, they turned this offer down, preferring to work with Congress directly.

One idea that opponents have often raised is to flip the burdens of the bill around to ban specific taxes during the moratorium rather than all taxes except those carved back in. This approach would require industry to identify taxes it opposes rather than requiring the states to identify taxes they wish to impose. However, Treasury believes that since states and municipalities best understand state and local tax issues, they are etter positioned than industry to identify which taxes should be permitted. We have not stated a position ublicly and we could refrain from expressing a view.

Other id as opponents have raised include grandfathering all existing taxes and shortening the morator um. The bill already grandfathers some taxes. Treasury's Office of Tax Policy believes that if the mor orium is significantly shortened, taxing authorities may choose to simply wait it out rather than actively engage in the study process. Moreover, shortening the moratorium may leave insufficient time for the s udy process to be effective.

Legisla ve H story

The bil was held up for many months by Senator Ted Stevens (R- AK) over his desire, unrelated to the tax asp ts of the bill, to require the FCC to revisit requiring Internet Service Providers to pay into the Univer Access Fund. On November 4, 1997, the Senate Commerce Committee reported out the bill by a stron vote of 14 to 5. A request by the Senate Finance Committee to review the bill sequentially is being c nsidered by the Parliamentarian but a previous request was denied. The next action is likely to occur i the House where Chris Cox believes supporters can move the bill out of the Commerce and Judicia committees.

In Dec mber 1997, Republican governors raised their concerns about the legislation to the Congressional leaders p. This has led to a dialog between Governor Leavitt (R- UT), the governors' point person on this iss e, and Congressman Cox on how to move forward. Cox is considering the states' proposal to redraft he bill to declare a moratorium on specific taxes rather than all taxes except permitted ones. Indust has so far resisted this approach. The Senate is likely to move the bill to the floor only after it is report d out in the House.

THE WHITE HOUSE

WASHINGTON

March 19, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

RE: INTERNET TAX FREEDOM ACT

Yesterday, the Big 7 and Representative Cox reached agreement on a new version of the Internet Tax Freedom Act. They are having a press conference on their agreement at 1 p.m. Senator Wyden has not been involved in these negotiations, and has not signed off on the current version of the bill.

Although we have not had time to study the bill in detail, we believe that it is generally consistent with your position, namely: (1) a short-term moratorium on new taxes on the Internet; and (2) a process for resolving the longer-term issues associated with the taxation of "remote commerce" (e.g. Internet and mail order sales.) Your advisers (NEC, IGA, Legislative Affairs, Treasury) think that it would be a mistake to fully endorse the bill at this point, given the lack of support from Senator Wyden and industry. We will release a statement from you (attached) that will call this an "important and constructive step," praise Romer and Leavitt, but stop short of a full endorsement.

Industry is currently split on the bill. Some of the large computer companies (e.g. IBM) are comfortable with the thrust of the legislation, although they will seek changes. Other companies, such as America Online, are concerned that the current draft "grandfathers" in existing Internet taxes. Direct marketing companies may oppose the bill as well, since they have been successful at preventing Congressional consideration of legislation that would overturn the "Quill" decision.

The compromise -- which is substantially different has two components:

1. It creates a 3 year moratorium on both taxes on Internet access and taxes that discriminate against electronic commerce.

2. It establishes a 29 member commission that has 2 years to draft legislation that would establish a national framework for state and local taxation of "remote commerce." This framework would include:

   - A single statewide sales tax rate -- with distribution to local governments;
   - Simplification of sales tax administration and use of technology to collect taxes;
   - A definition of "nexus."

The Big 7 organizations would each get to appoint 2 members of the commission, the NGA would appoint the chair, and the other 14 members would be appointed by the Administration and the Congress.

The legislation would then be submitted to the Congress for "expedited consideration."

If the legislation drafted by the commission is passed, states would have 4 years to adopt a single sales tax rate. Otherwise, they would not be allowed to tax "remote commerce." In addition, the moratorium on taxation of Internet access would be made permanent.

<u>You should know that Cox is telling industry that he would probably not support the legislation that this commission will produce</u>. Since the Big 7 will get to nominate 15 of the 29 members -- the commission will almost certainly recommend legislation that will repeal "Quill" and result in increased taxes on mail order and Internet sales. Cox is just arguing that the states and localities should get their "day in court."

THE WHITE HOUSE

WASHINGTON

April 28, 1998

MEMORANDUM FOR GENE SPERLING

FROM: TOM KALIL TAK

RE: "E-RATE" STATUS AND BACKGROUND

I. Glossary

In order to understand this issue, it is helpful to be acquainted with the following terms and programs:

Access charges: These are the fees (roughly $20 billion/year) that long-distance telephone companies pay to local telephone companies to originate and terminate phone calls. Long distance companies argue that these fees are dramatically above the actual costs of operating and maintaining the local network. Local phone companies argue that access charges are needed to keep the costs of residential phone service affordable. For example - they argue that the actual cost of providing residential service is an average of $40 per month, although consumers only pay an average $20 per month. Therefore, they argue, if access charges are reduced, residential rates will increase unless there is another mechanism for supporting universal service.

E-rate: This is the Administration's name for the provision of the Telecommunications Act of 1996 to broaden the definition of universal service to include schools and libraries. (The Act also provides discounts for rural health care providers.) Major features of the e-rate include:

- Discounts of 20-90 percent -- with the deepest discounts for the poor and rural schools;
- Coverage of telecommunications service, Internet access, and "inside wiring" (which includes wiring and networking equipment);
- A "cap" of $2.25 billion per year -- although the fund is not expected to be $2.25 billion in the first year; and
- Program administration by the "Schools and Libraries Corporation"(SLC).

Incumbent Local Exchange Carriers (ILECs): Local telephone companies like Bell Atlantic, Ameritech, Bell South, and GTE.

IXCs: Long-distance companies like AT&T, MCI, and Sprint.

Universal service: Universal service -- affordable phone service for every American that wants it -- is a long-standing goal of U.S. telecommunications policy going back to the Communications Act of 1934. It was re-affirmed and expanded in the Telecommunications Act of 1996. At the federal level, there is explicit support for universal service for low-income Americans and people living in "high-cost" (rural) areas. The explicit support, however, is only a fraction of the overall costs of universal service. Much of the support is "implicit" -- such as inflated access charges. Subsidies tend to flow from suburban, business, and long-distance customers to rural, residential, and local customers. An article in *Business Week*, for example, estimated the actual cost of phone service in Alaska to be $137/month. Although the Telecommunications Act of 1996 stated that support for universal service should be made more explicit -- many members of Congress are now not so sure that this is a good idea.

II. E-rate status and time line going forward

- The "window" for the first round of applications closed on April 15th. Roughly 30,000 applications have been received - from all different levels (e.g. schools, districts, state-wide networks) and all 50 states plus the District of Columbia.

- Sometime this week, the SLC should be able to estimate the total demand for discounts from schools and libraries.

- The FCC may have to submit a report to Congress on the "e-rate" by May 8th -- assuming a Hollings/Stevens/McCain amendment is attached to the supplemental.

- Depending on the time required to process the applications -- the SLC could be ready to send letters to schools and libraries in mid-May - early June. These letters will let the schools know the amount of the discount they will receive.

- In May, the FCC will have to make a decision about the size of the fund for the next half of 1998. Funding for the first half of the year was $625 million. In a letter to Reed Hundt, AT&T, Bell Atlantic, and NYNEX agreed to support the e-rate if it "ramped up" more slowly in the first year -- reaching a total of $1.75 billion in the first year.

III. Areas of controversy

1. Size of the fund: Many rural members of Congress (e.g. Senator Stevens, Senator Burns) are concerned that the "e-rate" will compete with the funds necessary to make rural phone rates affordable.

2. Coverage of the fund: SBC, Bellsouth and GTE have filed a suit against the FCC's "e-rate" order. One of their major concerns was that the "e-rate" covered "inside wiring." They argued that the FCC exceeded its legislative authority, and that it is not fair that companies like Cisco should be able to benefit from the fund without paying in to it.

3. **Administration of the fund**: The FCC has been criticized for setting up a government corporation without Congressional authorization, and for the salary of the SLC CEO. Senators Hollings, Stevens and McCain added language to the supplemental Appropriations bill to reorganize the SLC and to cap the salary of the CEO (currently $200,000).

4. **Impact of the "e-rate" on long distance phone bills**:

When former FCC Chairman Reed Hundt implemented the "e-rate" - he thought that AT&T would not raise rates if the FCC lowered their access charges - and that other long-distance companies would follow AT&T's lead. Access charges were lowered by $1.7 billion last July, and another $600 million is contemplated in July 1998.

However, the IXCs are arguing that they have already passed along the access charge reductions to consumers -- in the form of promotions such as "5 cent Sundays." AT&T argues that they only agreed not to include "schools and libraries" as a separate line item on the bill -- but they are free to add a line item to the bill to pay for all of universal service. The IXCs have already added "universal service" surcharges to business bills of roughly 5 percent -- and have put the FCC and the Congress on notice that they will add a surcharge to the bills of residential long-distance customers as well beginning in June. Approximately one-third of these surcharges would go to schools and libraries -- the other two-thirds would contribute to low-income and rural customers.

This is driving some members of Congress to put pressure on the FCC to decrease the size of the fund. Conservative columnists such as James Glassman have argued that the "e-rate" is a tax.

IV. Options (not mutually exclusive)

1. **Truth in billing**: The FCC and members of the Senate (e.g. Senator Rockefeller) have been advocating laws or FCC regulations that would require "truth in billing." For example, if the IXCs are going to start showing increased charges for universal service -- they should show the cost decreases that they have received from policy changes like reductions in access charges. This would show consumers that there has been no <u>net</u> increase in their phone bill. This may still not alleviate Congressional concern about the e-rate.

2. **Further reductions in access charges**: Some IXCs have argued that further reductions in access charges would eliminate the need for them to add a surcharge to residential phone bills. Of course, this would be strongly opposed by the ILECs.

3. **Reducing the size of the fund**: This is the least desirable option -- particularly if demand for the "e-rate" is high.

4. **Flat charge**: This is a long-term solution for 1999 and beyond. Long-distance companies could recover their "universal service" costs with a flat charge per long-distance phone bill of $1.00 - $1.50 -- depending on the size of the fund.

V. Process going forward

- NEC, OVP, Justice, Commerce, and Agriculture are continuing to meet on a weekly basis to discuss this issue.

- We need to increase senior Congressional support for the "e-rate." Although Senator Rockefeller is a strong supporter - the FCC continues to be under pressure from other members of Congress to reduce the size of the fund -- especially from rural Senators on both the Commerce and Appropriations Committees.

- We should definitely see if we can arrange a POTUS "e-rate" event when the announcement on the availability of discounts is made. We don't know at this point exactly when this will occur. It may be as early as mid-May - but we expect that it will be early June. The event should be bipartisan with a strong regional focus.

THE WHITE HOUSE

Office of the Press Secretary
(Monterey, California)

For Immediate Release June 12, 1998

STATEMENT BY THE PRESIDENT
FCC Decision on the E-rate

I applaud the decision by the Federal Communications Commission to move forward with the "e-rate" -- a critical initiative to connect our schools, libraries, and rural health centers to the Internet. Although I had urged that the e-rate be fully funded, I remain committed to the goal of ensuring that every child has access to the tools they need to compete in the 21st Century.

The e-rate will help create opportunity in the Information Age for children and communities all over America. Together with our Technology Literacy Challenge Fund, the e-rate will ensure that for the first time in our Nation's history, a child in the most isolated inner city or rural town will have access to the same universe of knowledge as a child in the most affluent suburb. Parents will be able to communicate more frequently with teachers, and keep up with the progress of their child in school. Our children will be "technologically literate" -- and better prepared for the high-tech, high-wage jobs our economy is creating in record numbers.

I call upon all members of Congress to support the FCC's decision. I will steadfastly oppose any effort to pull the plug on the e-rate and our children's future -- or to thwart the FCC's ability to move forward with this initiative.

-30-30-30-

UNITED STATES DEPARTMENT OF EDUCATION NEWS

FOR IMMEDIATE RELEASE
June 12, 1998

Contact: David Frank
(202) 401-3026 (office) or
Tom Lyon
(202) 543-7564 (home)

STATEMENT BY U.S. SECRETARY OF EDUCATION RICHARD W. RILEY regarding Federal Communications Commission (FCC) E-Rate decision

Today's decision by the FCC to fund the E-Rate is a first step in connecting America's school children to the Internet and preparing our children for the 21st century. Bill Kennard and other members of the FCC resisted the last-minute efforts of some long-distance carriers to stop the E-Rate even though they have received $2.4 billion in lower access rates.

While I am disappointed that the FCC did not fully fund the E-Rate, the funding plan endorsed by the FCC moves us in the direction of helping the poorest schools in this nation overcome the digital divide. If some in Congress go ahead with their threat to unplug the E-rate in the next two weeks they will soon get a reputation that is well deserved for being anti-education.

###

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

January 13, 2000

MEMORANDUM FOR ASSISTANT TO THE PRESIDENT GENE SPERLING

FROM: Stuart E. Eizenstat

SUBJECT: Internet Tax

Following up on our conversation this morning, I wanted to layout for you where we are on Internet tax. First, on inter-agency process, David Beier and Sally Katzen have been managing an inter-agency process to coordinate e-commerce which, I understand, has included Tom Kalil from the NEC. Treasury, as the lead agency on tax matters, has taken the lead on the Internet tax piece. David, Sally and Larry asked me to personally take this on. As the issue has developed, we have reached out to consult as appropriate with White House Legislative Affairs, Intergovernmental Affairs, Public Affairs, and the NEC. John Podesta held a Principals meeting before the last Internet tax Commission meeting. Both Larry and I welcome any involvement that you think would be appropriate from the NEC going forward and I believe David feels the same.

As to the Commission (which was appointed by Congress pursuant to the Internet Tax Freedom Act), it is considering several proposals at this point. An "anti-tax" proposal would prohibit states or localities from requiring remote sellers without a physical presence to collect sales or use taxes from residents. Commission member Governor Leavitt of Utah has proposed an alternative on behalf of the National Governors' Association under which states and localities would simplify their tax systems; provide technology for electronic collection of taxes on remote sales; and provide incentives to remote sellers to collect sales and use taxes. At our last meeting with David on Friday, we agreed to attempt to build consensus for a third proposal described in the attachment to this memo.

This week, the three Administration commissioners will be taking the temperature of the swing business members of the Commission to see if we can find champions for our preferred approach. We will meet again shortly to take stock and tweak our proposal if necessary. Next week, Secretary Daley, Secretary Summers and I will start calling CEOs in an attempt to gain support for our proposal. We are also drafting low-key outreach plans to the states and localities, key Hill members and companies not on the Commission who might be supportive.

Attachment

Revised Internet Tax Proposal (1/7/00)

Following are the elements of the Administration's proposal for the Advisory Commission on Electronic Commerce.

1. **Sales Tax Simplification and Nexus Standstill**
   A. The National Conference of Commissioners on Uniform State Laws (NCCUSL) draft a model sales tax law that incorporates appropriate simplification provisions. NCCUSL should receive funding from various stakeholders.

   B. Congress implement by resolution a five year "nexus standstill", that is, that Congress not alter existing nexus standards during the development by NCCUSL, and implementation by the states, of the model sales tax statute.

   C. Congress further study, for a period of five years, the issues associated with electronic commerce, including: Digital Divide issues, effects on state and local tax revenues, and effects on other forms of commerce

2. **Telecommunications Taxation**
   A. Oppose repeal of the federal excise tax on commiunications. While repealing the tax has some policy merit (*e.g.*, the tax may inhibit the use of telecommunications), repeal would cost the Federal government over $4 billion next year and $52 billion over 10 years and must be considered in light of other Administration priorities.

   B. Endorse the proposal submitted by the telecommunications industry during the San Francisco meeting. That is, Congress should recommend by resolution reformation of complicated and substantial state and local telecommunications taxes.

3. **Moratorium Extension (if asked only)**

The moratorium on Internet access taxation should be made permanent. **What about the other provisions of the current moratorium?** We will need to decide to what extent those provisions should be extended.

4. **International Tariffs**

The Administration supports an extension of the current moratorium on customs duties on electronic transmissions, with a view of making this extension permanent at the earliest possible date.

Tax

DEPARTMENT OF THE TREASURY
WASHINGTON

September 14, 2000

ASSISTANT SECRETARY

MEMORANDUM FOR GENE SPERLING
TOM KALIL

FROM: **JONATHAN TALISMAN**
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Possible "Digital Divide" Tax Incentives

The following summarizes our views on the "digital divide" tax proposals that you asked us to review in your prior memo. I apologize for the delay in responding to your request.

(1) Corporate donations of computers – expansion of Administration proposal.—We support a temporary extension and expansion of current-law section 170(e)(6), as proposed in the President's FY 2001 budget, through June 30, 2004 (when the R&E credit is scheduled to expire). Even so, we oppose the New Millennium Classroom Act (H.R. 2308 and S. 542) as introduced. However, there are some features of the congressional proposals that we could support building into the President's proposals. As part of a temporary extension of section 170(e)(6), we could support the following proposals:

(a) providing that the enhanced deduction under section 170(e)(6) could be claimed for computers that are up to three years old (starting from the date of manufacture or acquisition by the taxpayer, but not allowing the "clock to be restarted" by re-acquisition of a computer by the donor), provided that – as proposed by NEA – the donated computers meet the minimum standards prescribed by Treasury, which would reflect the mid-point performance standard of industry sales for three-year-old computers);

(b) allowing the enhanced deduction under section 170(e)(6) to be claimed by a corporate donor which re-acquires a computer which it previously sold to a customer (i.e., in the case of a re-acquisition, the original use of the donated computer need not be by the donor or the donee), provided that the computer is not more than three years old on the date of donation;

(c) expanding eligible donors under sections 170(e)(3), (e)(4), and (e)(6) to include all taxpayers (not merely C corps as under current law), but limit the enhanced deduction to 10% of business income (consistent with the current-law rule for C corps);

(d) expanding the class of eligible donees under section 170(e)(6) to include not only public libraries and community technology centers located in low-income communities (as under the President's FY 2001 budget) but also any charity, no matter where located, that is organized and operated primarily for purposes of providing computers without charge to lower-income families (as proposed by Mr. Jefferson in H.R. 4061); and

(e) clarifying that, in cases where a business taxpayer's adjusted basis in property of any kind (not merely computers) exceeds the property's fair market value, the taxpayer may abandon the property for purposes of section 165 (and thereby claim an abandonment loss equal to the property's adjusted basis) by giving the property to charity. In some cases, current law is not clear whether a business taxpayer is entitled to claim a higher deduction by throwing away used property than by donating it to charity.

We do not support the proposals to increase the amount of the enhanced deduction allowed under section 170(e)(6) or to allow taxpayers to claim a credit in lieu of an enhanced deduction. It would set a bad precedent to allow taxpayers to claim a charitable contribution deduction for unrecognized, built-in ordinary income beyond that allowed by the current-law rules. Moreover, although we have examined a proposal to repeal the "twice basis" limitation of section 170(e)(6), we understand that this limitation rarely comes into play with donations of computers (most of which have a high basis relative to the property's fair market value.

(2) Workplace literacy and computer training tax credit—expansion of Administration proposal.—We continue to oppose the congressional "IT Training Credit" proposal from last year (which would provide a credit for virtually all employer-provided technology training expenses that would be incurred in any event). However, we support expansion of the Administration's proposed 20% workplace literacy and technology training credit, so that the credit would be available not only for training expenses incurred for employees who lack a high school degree – as originally proposed – but also for training of employees who are (or had been during the last five years) eligible employees for purposes of the work opportunity tax credit or the welfare-to-work credit. We do not, however, think it is appropriate to provide a special credit for technology training provided to all low-wage employees, because defining "low-wage employees" in a way that the IRS could enforce would be very difficult, especially in the case of part-time workers.

You suggest clarifying the Administration's proposal so that it includes not only basic computer skills but "the kind of skills identified in the Conrad [IT Training] bill." We believe that all computer skills training for eligible employees generally would be covered by the Administration's proposal, provided that computer skills instruction is of "broad applicability." We could, however, modify the Administration's proposal so that, as long as the computer training is provided to an eligible employee and the training is of broad applicability (as opposed to being for a particular vendor's product), there would be no need to inquire as to whether the computer training was for "basic, entry-level computer skills" or for more advanced computer skills.

(3) Credit for sponsorship of qualified zone academies and technology centers.—The current Administration proposal provides for an allocated credit, which would be allocated for each designated empowerment zone and enterprise community by the local governmental agency

with responsibility for implementing the strategic plan that the area was required to agree to as part of the empowerment zone (or enterprise community) designation process. If we wanted this proposed credit also to be available for sponsorship of public schools or technology centers outside of designated empowerment zones or enterprise communities, we could also authorize the State's department of education (or any other agency designated by each State's governor) to make allocations of credits for up to $X of sponsorship payments to any K-12 public school or nonprofit community technology center located anywhere in the State (or perhaps anywhere in the State outside of an empowerment zone or enterprise community, which would continue to receive a separate credit allocation).

If a separate State-wide allocation were to be provided for, we would have to decide whether the State-wide allocation should vary based on each State's total population (or their respective populations below the poverty line, as with the current-law QZAB allocation regime, see sec. 1397E(e)(2)), and whether any adjustment should be made based on the number of designated empowerment zones or enterprise communities in each State.

With respect to this particular expansion of the Administration's proposal, we recently spoke to staff of Mr. Rangel, who was the original sponsor of this proposal. Mr. Rangel's staff suggested that a statewide allocation be limited so that it could be used only for corporate sponsorship of public schools that are eligible for QZABs (i.e., at least 35 percent of students are eligible for subsidized lunches). Mr. Rangel's office is concerned that, if there is a limited amount of corporate sponsorship money available, an expansion of the proposal to all public schools could decrease the likelihood that needier schools will receive corporate sponsorship payments. In addition, we may need to consider whether the proposal should be expanded to the so-called "Renewal Communities," which are to be designated under the New Markets agreement reached by the President and Speaker Hastert.

Employer-provided computers and internet access.—We are concerned about the precedent of providing tax-free treatment for employer provided computers, as proposed by the Digital Divide Access to Technology Act of 2000 (H.R. 4274), which was introduced by Jerry Weller and John Lewis on April 13, 2000. There would be more than incidental personal benefits for many employees, as well as their family members, under such an employer-provided program, yet (as discussed further below) there are no efficiency gains that could justify a tax preference for consumption of goods such as computers through an employer-based system.

Although there is some uncertainty regarding the tax treatment under current-law rules of employer-provided computers and internet access in certain situations, a preliminary estimate by Joint Committee is that H.R. 4274 would cost approximately $1.5 billion over the five-year budget window, which exceeds the cost of the Administration's entire "digital divide" package in its FY 2001 budget.

H.R. 4274 would provide tax-free treatment for employer-provided computers (with certain dollar caps) and internet access (without any dollar cap) for use by an employee and anyone else who resides in the employee's home. Proponents of the bill argue that it would simplify tax administration, by eliminating the necessity under current law to determine on an employee-by-employee basis whether an employer-provided computer and/or internet access is a non-taxable fringe benefit because it is sufficiently related to each employee's current job position. (This current-law test is most easily met by professionals, who also tend to have higher incomes.) Moreover, proponents argue that the proposal could be viewed as an expansion of section 127 to promote computer literacy. Currently, section 127 allows employers to provide tax-free educational assistance (including payments for tuition, equipment, and supplies) to their employees, but section 127 does not apply to "tools and supplies which may be retained by the employee after completion of a course of instruction."

However, in the case of employer-provided computers, there may not be any formal course of instruction for the employee, even though the item being provided by the employer has obvious personal/recreational uses. For example, Ford Motor Company plans on allowing all 350,000 of its employees to lease a home computer from Ford (and be provided internet access at home) for $5 per month, without regard to the whether the employee already is computer literate or whether he/she uses the computer solely for personal reasons or as part of a structured educational program. Industry representatives claim that there would be efficiency gains because rank-and-file workers will be using computerized equipment more and more over time, so using a computer at home would improve their skills at work. But there is no evidence that employees will acquire significant job skills from having a computer and internet access at home. Indeed, there is no guarantee that employees (as opposed to others in the household) will even use their home computers. Ford says that their unions have rejected any requirement that employees use their home computers for any work-related purposes, such as reading email messages. Thus, there is no evidence for an efficiency gain from mere access to home computers or the internet that could justify a tax preference, in contrast to other employer-provided fringe benefits such as health insurance or retirement benefits.

Putting aside for the moment the general issue of whether we support H.R. 4274, your memo suggests modifications to the introduced bill. Specifically, you suggest that H.R. 4274 be modified to explicitly include employer-provided broadband Internet access and that the tax-free treatment under the bill be increased from $35 to $60 per month to cover both broadband Internet access plus computer rental. We do not think that these suggested modifications to H.R. 4274 are necessary. First, the introduced bill already covers employer-provided Internet access, regardless of whether such access is "broadband" or not, so long as the Internet access is "made available to substantially all employees of the employer on substantially the same basis" (other than part-time or seasonal employees or those who work outside the U.S.). Second, the $35 per-month cap contained in the introduced bill does not apply to Internet access of any kind, but rather applies only to the rental value of the computer itself when ownership is not transferred to the employee. (Under the introduced bill, when ownership of the computer is transferred to the employee, the exclusion per employee is limited to an aggregate amount of $1,260 every three years.) The introduced bill contains no dollar cap on the value of employer-provided Internet access, so there is no need to take into account that broadband internet access is more expensive.

You also suggest that H.R. 4274 be modified to cover arrangements under which an employer leases a computer (which is then loaned to an employee) rather than transferring ownership of the computer to the employee. Again, such a modification is not necessary, because the introduced bill already provides for such arrangements.

(5) Computer purchases by EITC recipients.—We oppose Rep. Jefferson's proposal (which is part of H.R. 4061) to allow individuals who are eligible to claim the EITC for a taxable year to also claim a $500 refundable tax credit for 50-percent of the costs they incur to purchase computer equipment or software capable of providing Internet access. Although narrowly targeted in terms of the taxpayers eligible to claim the new credit, the proposal would raise serious policy and administrative concerns. First, the proposed tax credit would be of little help to the lowest income households, because the refundable credit would not be received until after a tax return is filed after the year in which the computer must be purchased.. Second, it would be difficult for the IRS to verify whether a taxpayer's claim of the credit is valid, without imposing significant reporting burdens on businesses that sell computers and software. Further, even if an information reporting system were established, it would be difficult for the IRS to ensure that qualifying individuals did not use the credit to purchase computers that they would then sell to non-qualifying persons. Finally, under the introduced bill, taxpayers could repeatedly claim a credit year after year (e.g., by claiming to purchase a computer one year, a new printer the next, and then software or an equipment upgrade after that). In view of these problems, Treasury believes that a better approach is to expand the EITC as proposed in the President's FY 2001 budget, which would provide low-income working families with additional resources (through advance payments made by the employer) that could be used not only for computers, but also other educational expenses, or other essentials, such as housing and child care.

(6) Broadband access.—We generally oppose the broadband investment tax credit proposals (both S. 2321 and the draft Moynihan proposal). These proposals would provide a tax credit for investment in broadband equipment, both to serve certain under-served geographic areas and to provide an incentive for investment in more advanced broadband technology regardless of the geographic areas to be served. As discussed in a more detailed memo previously sent to you, we do not think that it is appropriate to provide a preference for one type of Internet technology over other technologies. Moreover, the proposals would raise difficult administrative problems in trying to determine what portion of investment actually provides Internet access to persons residing in poor urban or rural areas, as opposed to the equipment, although located in a targeted geographic area, providing access to persons to located outside the targeted area. Moreover, the proposal would not help with the more fundamental problem that many persons located in poor urban and rural areas cannot afford Internet access.

(7) Teacher training.—We oppose legislation (H.R. 1075) that would increase the current-law Lifetime Learning credit rate to 50 percent, but only for elementary and secondary school teachers who incur out-of-pocket expenses to enroll in courses in which they receive "instruction on basic or advanced computer functions or computer software (including educational software offered by a single institution) approved for such individual by such local educational agency," provided that such the expenses are incurred "for the purposes of integrating materials covered by such course into the courses taught in the elementary or secondary classroom." This proposal would further complicate the already complex Hope

and Lifetime Learning credits, and would raise definitional issues and compliance problems in attempting to verify whether the technology training from a particular course was intended to be integrated into the teacher's curriculum. Under current law, expenses incurred for technology training at a post-secondary institution are eligible for the Lifetime Learning credit, which the Administration proposes to increase to 28% for all students and courses.

We also oppose H.R. 1076, which would allow elementary and secondary school teachers to claim a 100% credit (up to $2,000 lifetime cap) for costs incurred to purchase a computer, related peripheral equipment, or software (other than software primarily used for entertainment). This proposal raises numerous compliance problems.

April 10, 2000 -- Draft

MEMORANDUM

TO: **JOHN PODESTA**
GENE SPERLING
JACK LEW
CHUCK BRAIN

CC: **DAVID BEIER**
SALLY KATZEN

FROM: **SARAH ROSEN WARTELL**
LISA KOUNTOUPES
JOEL WIGINTON

RE: **APPROVAL OF LETTER TO DIGITAL SIGNATURES CONFEREES**

ISSUE PRESENTED

We seek your approval of the attached draft letter from Secretaries Summers and Daley to the Digital Signatures Conferees. The Conferees may have their first formal meeting this Tuesday. The letter was requested by Senate Democrats seeking the Administration's endorsement of their views, reflected in a letter from all 45 Democratic Senators to the Conferees (copy also attached). The Administration letter has completed OMB clearance and does not require formal West Wing clearance; however, we thought this a good occasion to ensure you are comfortable with the current Administration's strategy on this legislation.

The letter to conferees indicates the Administration's support for removing legal barriers to electronic commerce. Specifically, it states our support for both: (1) **contract formation provisions** that ensure that contracts shall not be denied legal effect or enforceability solely because electronic signatures or records were used in their formation; and (2) **appropriate records provisions** regarding the legal validity of electronic records (e.g., notices, disclosures, and other records retained in electronic form). (Recall that, in the House, we supported an alternative without any records provisions, volunteering only to work constructively to develop "appropriate legislation.") At the same time, the letter makes clear that there should be equivalent (but not greater) protections for consumers in the electronic world to those they have in paper transactions. Finally, the letter endorses the five principles set forth in the Democratic Senators' letter (which were developed in conjunction with the Administration) and notes "that the final legislation must incorporate [them] in order to gain Administration support."

The letter does not raise preemption issues, which are the primary concern of State Governors, Attorneys General, and Legislatures. Under the Uniform Electronic Transactions Act (UETA), States have the authority to exclude certain consumer protection requirements from their State law's coverage. California excluded many requirements, especially in the insurance area, and it provoked industry to seek a requirement in this Federal law that State law is entirely preempted unless the State adopts UETA exactly in the form adopted by the National Conference of Commissioners on Uniform State Laws. The legislation also would bar States from imposing any record retention requirements (i.e., mandating the form in which firms must retain their electronic records for access by regulators). States have written letters, but have not yet engaged effectively. We are sympathetic to their concerns, but have limited leverage to protect Federal requirements and, thus, cannot make preemption our fight.

The Senate Democratic letter was developed, in part, to increase the Administration's and the Senate Democrats' leverage in conference. They sought to demonstrate Democratic solidarity. Thus, they chose not to include language that some members had sought (especially Senators Sarbanes and Leahy), but which others said reflected too high a bar. The Democrats believe that a comparable statement from the Administration is now essential to maintain that leverage.

We worked closely with Senator Daschle as the five principles in the Democratic Senators' letter were developed. Various approaches may work to satisfy these objectives. The principles were reflected in a draft of the bill released by Senator Wyden and Leahy developed with our heavy assistance. We have discussed that draft extensively with industry representatives. While they have raised important technical issues, we believe that final language could be crafted that meets the Democrats' principals and the industry's objectives in seeking legislation. We cannot provide assurance, however, that Republicans active in the Conference Committee (especially Senators Gramm, McCain, and Abraham and Conference Chairman Bliley) will be willing to fully met these objectives. And we have reason to believe that many Senate Democrats, notwithstanding their letter, want to support the final conference product regardless of how well it addresses these concerns. However, we believe this letter gives us appropriate flexibility.

BACKGROUND

The Conference Committee will be made up of five house members (3-2) and 17 Senate members (10-7). Senator Abraham has had the lead in the Senate thus far and wants an accomplishment this year. He and Senator McCain seem open to at least some of the ideas that are important to us, especially as some in industry argue that they should accommodate our concerns in order to quickly complete this conference. Senator Wyden wants a bill, but the other lead Senators – Hollings, Sarbanes, and Leahy – may seek more changes than the traffic will bear and criticize us for insisting on too little. Chairman Bliley seems open to resolving the legislation amicably, but clearly wants ownership; Representative Markey wants to help us find a way to get changes that are important to us (despite his support for the House legislation in its current form) but will not fall on his sword if unsuccessful. There is no conferee whose interests are perfectly aligned with ours, although Wyden and Markey are closest. Both would put up little resistance if simply presented with the House bill, but both seek improvements aimed at addressing reasonable consumer concerns.

No one is sure what role Senator Gramm will play. Hollings and Leahy staff report that they are working cooperatively with the other Republicans, but Gramm is absolutely unwilling to consider the ideas that the Senate Democrats are promoting, even where industry seems willing or even enthusiastic. Reportedly, he has chastised lobbyists for even talking to the Democrats and the Administration. Gramm and Abraham have released a set or principles of their own and are said to have a draft bill. While it is reportedly similar to the House bill in many ways, they are insisting that it is far superior. Thus, even if agreement is reached with industry, an agreement with the Conferees – or at least with Gramm -- may be difficult to obtain.

The Administration's primary objectives are to get changes made to the House bill to accomplish the following goals (in order of priority). We recognize that we will be unable to get all of our concerns met and are already working on alternative language where concerns have been raised by industry. We hope to convince a Republican (ideally Bliley in consort with Markey) to offer much of our revised approach as a compromise. If advanced by a Democrat, it will not survive.

1. **Enhance legal certainty and avoid unnecessary litigation by authorizing regulators to provide interpretive guidance.**

House bill: The bill is self-executing. As such, no agency has the ability to interpret its provisions. Moreover, agencies' ability to interpret statutes, under which they have regulatory authority, as modified by this bill, is unclear. So, for example, if a statute requires that a disclosure be provided at a particular time, in a particular form, and it is now provided electronically, questions can arise whether or not the time and form requirements have been met or were modified in some way by this act.

Proposal: We argued that interpretive authority is essential, both to prevent creative interpretations that allow predatory practices, and to provide industry certainty. Without it, they might face class action lawsuits by parties alleging that requirements of underlying statutes were not met.

Industry response: Industry is supportive, provided language is clear that interpretations cannot create exceptions to the Act's requirements. They also seek language encouraging regulators to adopt consistent interpretations. These changes are fine.

2. **Ensure Effective Consumer Consent to the Replacement of Paper Notices with Electronic Notices.**

House bill: Provides that, if a statute requires that a notice or disclosure be in writing, that requirement can be satisfied by an electronic record (e.g., e-mail, or posting the notice on a website), if the consumer affirmatively consents, after being notified of the hardware and software requirements for access to and retention of the record. Moreover, the House bill creates an affirmative obligation (not imposed in the paper world) for the consumer to notify the provider of any change in their email or electronic location.

Proposal: To ensure equivalent treatment, we propose to eliminate the new duties for the consumer. Moreover, we recommend that the consumer be informed of the specific types of records that they are consenting to receive electronically and the right to receive the record in paper (if the have the right under law and the business gives that as an option). And we propose that the consumer's consent be provided electronically from the same email account or other electronic method of access, so as to demonstrate that the consumer has the capacity to receive notices electronically. For most consumers, a recitation of necessary hardware and software requirements will be confusing; many could consent when in fact they would be unable to access their own records. We also propose that, if the company changes its technology requirements so there is a material risk the consumer will be unable to read the notices, a new consent must be obtained.

Industry Response: While some complain about the burden, most acknowledge this would create a more effective form of consent. However, technical issues have been raised about ensuring this works not only for email accounts but also for web-based transactions. We think we can draft alternative language to resolve that concern. Industry also complains about the burden of obtaining new consents and we are far less likely to get much on that issue.

3. **Ensure that Electronic Records are Accurate and Relevant Parties Can Retain and Access them.**

House bill: Says that, if a statute requires that contract or record be retained, the requirement can be met by retaining an electronic record, if it accurately reflects the information in the contract or record and remains accessible for as long as the statute requires.

Proposal: We suggest technical changes to ensure the information is accessible to the consumer and others entitled by law, not just to the company. We are also concerned that some technologies may make it impossible to determine whether or not something is an accurate version of the original record, but we recognize that nothing could be guaranteed to be "unalterable." So we propose a middle ground: the record should be preserved in a form that "provides assurances of the accuracy and integrity of the ... record substantially equivalent" to those assurances provided by a written record." Thus technology could adapt.

Industry response: Technical drafting issues but no substantive objection.

4. **Avoid unintended consequences in areas outside the scope of the bill by providing clear federal regulatory authority for records not covered by the bill's "consumer" provisions.**

House bill: While most of the attention has been given to bill provisions that affect consumer transactions, there are other cases where federal law establishes requirements for notices and disclosures provided between private parties. For example, workplace safety and hazardous waste transportation notices.

Proposal: We propose that federal agencies be able to supercede the bill's requirements if they affirmatively act, after passage of this law, because they believe that electronic delivery could undermine the intention of the underlying requirement. Thus, OSHA could act issue new regulations requiring that hazard notices be physically posted in certain places, because electronic notice would not suffice for safety purposes.

Industry response: No objection raised thus far, although we expect they may request that there be some standard met before agencies can supercede the bill's requirements. Alternatively, the Gramm-Abraham draft may address the problem by narrowing the scope of the bill to not cover these types of notices.

5. **Avoid facilitating predatory or unlawful practices.**

House bill: No specific provisions. Consumer groups are especially worried about predatory lenders and scam artist. They fear they will bring a laptop into the home of a vulnerable person and trick or coerce them into foregoing the right to receive paper records and notices that might warn them against the transaction or at least provide a way to trace the scam after the fact. Too many of these people may not have computers of their own and will never have the ability to access and retain the records they "receive" electronically.

Proposal: We would take some solace from the availability of interpretative authority and the requirement that the consent be provided using the same email account or other mechanism to which notices will be sent, demonstrating consumer access. The Wyden-Leahy draft also contained a provision that would make a consumer's consent ineffective if induced in an unfair or deceptive manner.

Industry response: The industry violently opposes the Wyden-Leahy language, which they view as creating new "unfair and deceptive acts and practices" (UDAP) authority. (Under current law, Federal banks and thrifts are only subject to UDAP if the Federal Reserve first determines that a practice is unfair and deceptive. They never have.) We will propose instead a savings clause, clarifying that nothing in this bill affects any existing federal or state UDAP authority. But this will be most difficult to get and we may need to simply argue that the interpretive authority gives us the ability to protect against predatory practices.

6. **Other.**

Federal Government Interests: We also proposed changes to: (1) ensure that the SEC retains authority to impose requirements necessary to protect investors; (2) exempts federal government contracts; (3) allows the Federal government to impose requirements for contracts that it guarantees; and (4) preserves federal record keeping and other requirements, when implemented by the states, as under the environmental laws. We have received no objections to these provisions, although we suspect that there will be a fight about the SEC issue, in which the SEC will have to engage.

U.S. TREASURY DEPARTMENT

STUART E. EIZENSTAT
DEPUTY SECRETARY

tax

FACSIMILE TRANSMITTAL SHEET

TO: GENE SPERLING DAVID BEIER	FROM: DEPUTY SECRETARY EIZENSTAT
FAX NUMBER: 456-2878 456-6231	DATE: OCTOBER 5, 2000
COMPANY:	TOTAL NO. OF PAGES (INCLUDING COVER): 5
PHONE NUMBER:	SENDER'S PHONE NUMBER: 202-622-1080
SUBJECT: INTERNET TAX	

☐ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT

☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

Tax

I assume we should now be for no extension. That's where I am.

G
10/31/00

File

int.
cc: Khalil

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

October 5, 2000

MEMORANDUM FOR GENE SPERLING
Assistant to the President for Economic Policy

DAVID BEIER
Chief Domestic Policy Advisor
Office of the Vice President

FROM: Stuart E. Eizenstat

SUBJECT: Internet Tax

I am writing to share some information regarding Internet tax legislation and to raise some questions that we might want to consider about how to move forward on this issue.

Chuck Marr told me and others at Treasury that Senator Daschle is absolutely opposed to any extension of the moratorium at this time, a message Chuck said he conveyed to the White House as well.

Senator Daschle's position was also conveyed to me today during a meeting with Peter Lowy and Lisa Cowell of the E-Fairness Coalition. Their position is that the best course of action would be for there to be no Internet tax legislation passed this year. They asked that we oppose any Congressional proposal to adopt an extension of the moratorium, even a two-year extension, which we had supported in the spring. They expressed the view that the States have made significant progress on tax simplification and that Senators Dorgan and McCain are very close to agreement on a bill authorizing the States to enter into a compact. They believe that the parties are being motivated to act by the threat of a "free-for-all" when the moratorium ends in October 2001, and they fear that this momentum will be stymied by any extension of the moratorium.

On Wednesday, September 20, I met with Senators Graham and Enzi on this issue, and they also expressed their opposition to any extension of the moratorium. Senator Graham said that any extension of the moratorium was the "equivalent of surrender." He said he viewed it as a "big gift" to Internet retailers and strongly encouraged the Administration to exact a "quid pro quo" if it supports a two-year extension. He said that, in his view, the Administration has enormous power on this issue to influence the final outcome. Senator Enzi expressed the belief that the failure to extend the moratorium will provide an incentive to state and local governments to enact simplified and streamlined sales tax legislation.

I informed the Senators that we would consider their suggestion regarding a quid pro quo, but made no commitments. For example, one possibility might be to include language in the extension that would require expedited Congressional review of State simplification efforts for the purpose of determining whether States may impose a tax collection obligation on remote, including Internet, sellers.

In both meetings, I articulated the Administration's position that we support a short-term, two-year extension of the moratorium, through October 2003, but oppose long-term extensions such as the five-year extension contained in the bill passed by the House earlier this year. I also took this opportunity to explain our opposition to Internet access taxes and to the European Commission's VAT proposal.

I believe, however, that there is merit to the argument that an extension of the moratorium may not be prudent at this time based on the changing political landscape. Such a position would not conflict with the existing Administration position, as we could still support the adoption of a two-year moratorium extension next year when the current moratorium is about to expire. In other words, we might state that it is too early to commit to an extension at the present time because the States and Congress are making significant progress. When the moratorium is about to expire next October and we have more information about whether simplification efforts have been successful, we could at that time support a two-year extension of the moratorium. Since the moratorium extension does not take effect until October 2001, we could argue that there is no reason to rush to judgment now.

I suggest that we schedule a meeting or phone call to discuss these issues shortly. I would appreciate hearing your thoughts so I can get back to the Senators and the Coalition members. ~~I am also enclosing a memorandum on the issues the Senators raised.~~

Enclosure

Memorandum on Internet Tax Issues

Senators Graham and Enzi asked us to examine several issues regarding Internet tax and the moratorium pending on the Hill.

Congress has the legal authority to authorize States to collect tax from remote sellers, but is not likely to exercise it. In *Quill V. North Dakota*, the Supreme Court found that requiring remote sellers to collect use tax placed a burden on interstate commerce that violated the Commerce Clause of the Constitution. That ruling was based primarily on the Court's finding that the burden came from an extraordinarily complex system of state and local sales and use tax. Because the Commerce Clause is one of the "reserved power" clauses, Congress has authority over the issue (as opposed, say, to the Due Process Clause, which Congress does not have the power to override). Therefore, Congress can act to allow the States to do what would otherwise be unconstitutional in the absence of Congressional action. In this case, Congress could act to authorize the States to impose a tax collection obligation on remote sellers, regardless of whether the States take any action toward simplification of their existing laws.

Thus, there are two ways that the States can get the power to impose collection obligations on remote sellers. (1) Congress could enact legislation giving the States the authority to do so; or (2) the States could simplify their sales and tax systems to such an extent that the Court would find the obligation to collect no longer imposes an impermissible burden on interstate commerce pursuant to *Quill*.

Both Michael Mundaca and Frank Toohey agree that there is little chance Congress would grant the States the authority to impose collection obligations on remote sellers. Former Senator Bumpers tried for many years to persuade his Senate colleagues to overturn *Quill* without success. His legislation never received more than 25 votes on the Senate floor. Senator Dorgan has met with even less success in his similar efforts. He was never able to persuade his former colleagues on the House Ways and Means Committee to vote to overturn *Quill*, and has been equally unsuccessful in the Senate.

Recognizing that there is little chance of Congress' overturning *Quill*, the States are moving to simplify their tax systems. Nevertheless, the legal status of a simplified system would remain uncertain and subject to challenge. Thus, once their tax systems are simplified, the States will have two choices: (1) to impose the obligation, wait for a legal challenge and let the Courts rule again; or (2) to go back to Congress and argue that Congress should now give States the authority to force collections because the simplified tax laws represent a change in circumstances.

Pursuing the Uniform Commercial Code approach entails some risks for the States.
In their efforts to simplify their remote seller tax regimes, the States are seeking uniformity of their laws. However, the Constitution prohibits the States from joining together on issues related to interstate commerce. Thus, the States have two options to work together to solve common issues:

1. They can get Congress to authorize the States to form compacts. Congress, for example, authorized the States to organize regional compacts to resolve the issues related to the disposition of low-level nuclear waste material; or

2. They can join together to develop a model statute that all would be free modify and adopt. No penalties, however, could be imposed for failure to adopt them.

The states are currently pursuing the model statute option through the Streamlined Sales Tax Project, which is an attempt to develop a model law to simplify sales tax administration and collection, similar to the process followed years ago to develop the Uniform Commercial Code ("U.C.C.").

The risk with this approach is that, unlike with the UCC, only a few states may choose to adopt these new standards or those that do may amend them so much during their legislative process that much of the simplicity is lost. Another risk is that any model statute adopted by the States may not simplify the law sufficiently for the courts to overturn existing law or for Congress to take action.

Congress can help the States to avoid some of these potential pitfalls if it acts now, in conjunction with extending the moratorium, to authorize the States to form a compact under which they would be able to develop uniform laws for the collection of taxes on remote sellers and/or to set terms under which the compact could impose taxes without further Congressional action. This scenario would enable Congress to set the terms of the compact now and could avoid the need for separate legislation to authorize the States to collect taxes.

It is unlikely that the Administration will be able to extract a "quid pro quo." It may be because of the risks associated with the current multi-State effort underway that Graham is seeking a "quid pro quo."

Both Mike and Frank believe that Graham is mistaken if he believes the Administration can extract a concession for a moratorium extension. If it were possible, such a concession might take one of two forms:

1. The moratorium extension might include language that would require expedited Congressional review of State simplification efforts for the purpose of determining whether States may impose a tax collection obligation on remote sellers; or

2. Alternatively, it might include language in the extension that would enable the states to implement whatever simplification plan they develop without further Congressional action.

Still, Mike and Frank do not believe either option is politically feasible.

THE WHITE HOUSE

WASHINGTON

February 6, 1998

MEMORANDUM FOR THE PRESIDENT

From: Gene Sperling GBS
Director, National Economic Council

Mickey Ibarra MI
Director, Intergovernmental Affairs

Lawrence H. Summers
Deputy Secretary of the Treasury

Re: Internet Tax Freedom Act (Cox-Wyden Legislation)

ACTION FORCING EVENT

Congress is currently considering legislation (The Internet Tax Freedom Act, S. 442, H. 1054) introduced by Senator Ron Wyden (D- OR) and Congressman Chris Cox (R- CA) to impose a moratorium on new or discriminatory state taxation of the Internet. The legislation provides for a study process to develop policy recommendations and is aimed at permitting electronic commerce to develop free of distortionary taxes imposed by myriad jurisdictions. It is based on principles set forth in a Treasury policy paper, in the July 1, 1997 *Framework for Global Electronic Commerce* and in your Presidential Memorandum on electronic commerce and is consistent with the position we have taken in international discussions.

Industry, not surprisingly, strongly supports the bill. Earlier this year, seven CEOs belonging to the Computer Systems Policy Project, including Lou Gerstner of IBM, Lew Platt of Hewlett Packard and Lars Nyberg of NCR met with Secretary Rubin and Deputy Secretary Summers to urge full support.

State and local groups such as the National Governors' Association, the US Conference of Mayors, NACO, the National League of Cities as well as elected officials, however, strongly oppose the bill as usurping their ability to tax (though officials from high tech states such as Governors Wilson, Pataki and Cellucci support it.) Opponents have been slow to identify specific problems that might be fixed but cite lost sales tax revenues if on-line sales cut into store sales that would generate taxes. They are concerned that while consumers are liable for taxes on mail-order sales, those taxes are rarely collected. State and local groups have said that the legislation "will lead to Main Street stores and small businesses ... across America being forced to close due to the discriminatory impact of a sales tax levied only on retail stores, not their Internet competitors." In view of the federalism issue, last summer, Deputy Secretary Summers testified in favor of the bill's goals and principles but stopped short of endorsing it. Earlier this month, he proposed to the Big Seven state and local organizations that we work jointly on a bill that addresses their concerns. They declined the offer while suggesting that we continue to talk. The Big Seven rejected the offer because they believe that they can continue to delay or kill the legislation, and are not motivated to work with us until it is absolutely necessary.

On November 4, 1997, the Senate Commerce Committee reported out a bill. We understand that the Senate will wait for the House. Our active support is likely to help the bill and satisfy high tech proponents while withholding support would partially satisfy state and local groups. Your guidance is sought on whether to take a more active position in support of the bill and therefore take credit for its passage or continue to maintain a low profile. A strong announcement of support early this session would probably carry the most weight. IGA would prefer that we wait until mid-March, to avoid needlessly antagonizing the Big Seven groups, who will be having meetings in February and early March.

OPTIONS

A. Actively support the legislation while soliciting state and local views in order to address any flaws and legitimate concerns

This option will give us the opportunity to take credit for an anti-tax initiative that will be beneficial to the development of electronic commerce. From an economic point of view, preventing new taxes on a network that provides so many public benefits is good policy. The Senate version has been improved to where Treasury's Office of Tax Policy now feels we can support it, though some technical and substantive problems remain. This option will initially increase pressure from state and local opponents. However, as the legislation moves forward, opponents are likely to increasingly value our offer to use our offices to address their remaining concerns.

B. Continue current posture (support goals and principles without endorsing legislation)

This option while frustrating high tech proponents would initially do more to satisfy state and local concerns and might lead to the bill's failing to pass. However, if the bill passes in its current form, anything short of a veto will still upset state and local opponents. If we take a lower profile, we will also have less influence to improve the bill.

RECOMMENDATION: Your economic and political advisors (Treasury, Commerce, NEC, IGA, OMB, and Ira Magaziner) recommend Option A. They believe this legislation will foster electronic commerce which is emerging as an important engine of growth while preserving our ability to address the legitimate concerns of state and local governments. Withholding support may cause the legislation to fail, or if it passes anyway, subject us to strong pressure to veto a bill that we believe merits support.

__ Agreed   __ Disagreed   __ Let's Discuss

BACKGROUND AND ANALYSIS

The Internet Tax Freedom Act would permit states to continue to collect existing, non-discriminatory taxes but imposes a moratorium on new or discriminatory ones and calls for a study process. Both bills call for you to appoint a commission representing the states, industry and the Administration, which will then issue recommendations which you may submit to Congress. The current Senate version of the bill ends the moratorium in approximately five years on January 1, 2004, which we think is appropriate.

The Administration's Actions So Far

Treasury first set forth the principle of tax neutrality for the Internet at the international level in its paper, *Selected Tax Policy Implications of Global Electronic Commerce*, released in November 1996. That goal was adopted by the sponsors of this legislation.

Deputy Secretary of the Treasury Summers testified last summer in favor of the goals and principles of the legislation but, at that early stage, stopped short of endorsing it. In his testimony, he set forth three guiding principles: first, that commercial activities conducted by means of the Internet should not be subjected to new or discriminatory taxes; second, that the Internet should not become a tax haven; and third, that we should be highly sensitive to concerns about federalism. In short, we supported technology neutral, non-discriminatory, taxation of electronic commerce that preserved the state and local tax base. The goal of tax neutrality was then incorporated in the July 1, 1997 paper, *A Framework for Global Electronic Commerce* and included in your July 1, 1997 Presidential Memorandum on electronic commerce. We have adhered to this principle in international and domestic tax policy discussions.

Efforts to Address State and Local Concerns

With the exception of officials in high tech states such as Governors Pataki, Wilson and Cellucci, most state and local officials oppose the legislation on the grounds that it inappropriately restricts their right to tax. They are particularly concerned that rapid growth in electronic commerce will come at the expense of store sales and, if treated like mail order sales for tax purposes, will cut into sales tax revenues. In fact the bill is silent on whether neutrality means neutrality with store sales where merchants must collect "sales tax" or neutrality with mail order sales where consumers owe "use tax" but merchants are not required to collect them. Nor does it address the thorny issues of "nexus" or where the sale takes place for tax purposes.

As a practical matter, states will face the problem of how to collect tax on out-of-state Internet sales whether the bill passes or not. The bill, as written, neither worsens nor solves their problem. Attempting to solve it would probably mean addressing the complex issue of mail order taxation. Recently, a proposed deal between the Direct Marketing Association and several large states on the mail order issue fell apart after strong negative reaction from mail order customers.

Since legislation was introduced, Treasury officials have met with the Multi-state Tax Commission, the Big Seven group of state and local organizations representing elected officials, and others to address specific concerns. While state officials generally expressed more interest in killing the bill than in identifying specific problems with the language of the bill, Treasury did communicate specific suggestions we received, as well as our own concerns, to drafters who incorporated most of them in the Senate bill. In January, Deputy Secretary Summers made an offer to representatives of the Big Seven state and local organizations to work jointly on a bill addressing the states' larger remaining concerns. However, after some consideration, they turned this offer down, preferring to work with Congress directly.

One idea that opponents have often raised is to flip the burdens of the bill around to ban specific taxes during the moratorium rather than all taxes except those carved back in. This approach would require industry to identify taxes it opposes rather than requiring the states to identify taxes they wish to impose. However, Treasury believes that since states and municipalities best understand state and local tax issues, they are better positioned than industry to identify which taxes should be permitted. We have not stated a position publicly and we could refrain from expressing a view.

Other ideas opponents have raised include grandfathering all existing taxes and shortening the moratorium. The bill already grandfathers some taxes. Treasury's Office of Tax Policy believes that if the moratorium is significantly shortened, taxing authorities may choose to simply wait it out rather than actively engage in the study process. Moreover, shortening the moratorium may leave insufficient time for the study process to be effective.

Legislative History

The bill was held up for many months by Senator Ted Stevens (R- AK) over his desire, unrelated to the tax aspects of the bill, to require the FCC to revisit requiring Internet Service Providers to pay into the Universal Access Fund. On November 4, 1997, the Senate Commerce Committee reported out the bill by a strong vote of 14 to 5. A request by the Senate Finance Committee to review the bill sequentially is being considered by the Parliamentarian but a previous request was denied. The next action is likely to occur in the House where Chris Cox believes supporters can move the bill out of the Commerce and Judiciary committees.

In December 1997, Republican governors raised their concerns about the legislation to the Congressional leadership. This has led to a dialog between Governor Leavitt (R- UT), the governors' point person on this issue, and Congressman Cox on how to move forward. Cox is considering the states' proposal to redraft the bill to declare a moratorium on specific taxes rather than all taxes except permitted ones. Industry has so far resisted this approach. The Senate is likely to move the bill to the floor only after it is reported out in the House.

Sarah Rosen Wartell
10/09/2000 03:54:39 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc: Ruth M. Samardick/OPD/EOP@EOP
Subject: Human Rights Watch and CARE ACT

Blue folder -- low priority

In regards to the letter you received from HR Watch urging us to push for CARE Act in proverbial "endgame" perhaps on Minimum Wage, you wrote "seems like a heavy lift at this point."

Ruth and I spoke with Jo Becker of HR Watch and said the same very tactfully. We said we'd be delighted if the bill were enacted, but given the current state of play, didn't see an obvious way to get it down. Pointed out that -- re minimum wage -- Democrats are working hard to strip the bill of bad FLSA provisions. Would be hard to conceive of Rs agreeing to put in a good FLSA provision except at the cost of provisions that organized labor and other friends strongly oppose. I think the call ended well. She understood we were ready to try to help but there wasn't a good way to do it -- but open to ideas if they had any. It was clear there was little understanding of the status of min wage (or lack thereof) so just sharing seemed to help.

Message Sent To:

Gene B. Sperling/OPD/EOP@EOP
David Tseng/OPD/EOP@EOP
Elliott H. Baer/OPD/EOP@EOP
Joseph N. Crisci/OPD/EOP@EOP
Christopher M. Wanken/OPD/EOP@EOP
Sylvia M. Vellino/OPD/EOP@EOP
Amy Mall/OPD/EOP@EOP