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The Internet Tax Freedom Act at 25

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The Internet Tax Freedom Act at 25

by Walter Hellerstein and Andrew Appleby

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In this article, Hellerstein and Appleby review the Internet Tax Freedom Act and the litigation it spawned and consider whether the act is "fit for service" in today's digital economy.

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I. Introduction

In October 1998 Congress enacted the Internet Tax Freedom Act (ITFA), a temporary three-year "moratorium" on the enactment of new state and local "taxes on Internet access" and on "multiple or discriminatory taxes on electronic commerce."[1] At the same time, Congress created the Advisory Commission on Electronic Commerce to study and, within 18 months, report on the issues raised by such taxes, along with legislative recommendations designed to resolve these issues and, presumably, to allow the temporary moratorium to expire in light of the adoption of federal legislation.[2] In November 2001 Congress retroactively extended ITFA for two years through October 2003.[3] In late 2004 Congress again retroactively extended the act, this time through November 2007.[4] In 2007 Congress once again extended the act for an additional seven years through November 1, 2014.[5] In December 2014 Congress retroactively extended the act through October 1, 2015.[6] After yet again extending the act temporarily at the end of 2015, Congress in 2016 finally and controversially struck the language temporarily extending the act, thereby making it permanent.[7]

The statute, which still lacks its own section in the United States Code, can be found at 47 U.S.C. section 151 (note). With its idiosyncratic legislative history and statutory language, as well as the recent attention it has received in connection with legal challenges to digital

[1] The Internet Tax Freedom Act, P.L. 105-277, section 1101(a)(1), Tit. XI, 112 Stat. 2681 (1998).

[2] *Id.* section 1102; *see* Walter Hellerstein, "Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce," 90 *J. Tax'n* 5 (1999).

[3] Internet Tax Nondiscrimination Act, P.L. 107-75, section 2, 115 Stat. 703 (2001).

[4] P.L. 108-435, sections 2-6A, 118 Stat. 2615 (2004).

[5] Internet Tax Freedom Act Amendments Act of 2007, P.L. 110-108, sections 2-6, 121 Stat. 1024 (2007).

[6] Consolidated and Further Appropriations Act, 2015, P.L. 113-235, Tit. VI, section 624, 128 Stat. 2377 (2014).

[7] Trade Facilitation and Trade Enforcement Act of 2015, P.L. 114-125, Tit. IX, section 922, 130 Stat. 281 (2016). The legislative history illustrates the contentious debate surrounding ITFA's continued necessity given the digital economy's transition from "a nascent development in need of Federal tax protection to grow" to "a prosperous sector of the global economy." H.R. Rep. No. 113-510, p. 18 (2014).

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services and analogous taxes,[8] we thought it would be appropriate to commemorate ITFA's 25th birthday by reviewing the act and the litigation it has spawned and to consider whether it is "fit for service" in today's digital economy.[9]

II. ITFA's Provisions and Their Interpretation

A. Overview of ITFA's Prohibitions

ITFA prohibits three types of taxes: (1) taxes on internet access; (2) discriminatory taxes on electronic commerce; and (3) multiple taxes on electronic commerce. In considering the ensuing materials, including, in particular, the various amendments to the original statute that we examine below, one should keep in mind that the technology, business models, and charges associated with access to and use of the internet have evolved dramatically since ITFA was originally enacted in 1998.

B. Taxes on Internet Access

The prohibition against taxes on internet access forbids states from taxing charges for "a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet."[10] The statute plainly forbids states from taxing the monthly fee that internet access providers charge their customers for connecting to the internet. The original prohibition contained a flat exclusion of telecommunications services from the definition of internet access.

1. The 2004 Amendment to the Definition of Internet Access

The 2004 extension of the ITFA moratorium added language making it clear that all forms of internet access were covered by the moratorium, including high-speed wireline and wireless services, that is, "telecommunications services . . . purchased, used, or sold by a provider of Internet access to provide Internet access."[11] Thus, the 2004 amendments to ITFA would appear to reverse decisions in cases like *America Online Inc. v. Pennsylvania*,[12] which held that the pre-2004 version of ITFA did not bar a Pennsylvania tax on port modem management services that, among other things, converted information transmitted over the internet from digital to analog format for transmission to customers, and *Concentric Network Corp. v. Pennsylvania*,[13] which held that the pre-2004 version of ITFA did not bar a Pennsylvania tax on an internet service provider's (ISP's) purchase of data transport services used to provide internet access.

Indeed, it is not even clear that the decision in *Concentric* was properly decided under the pre-2004 version of ITFA. The Pennsylvania tax did not apply to data transport services purchased by cable companies and telecommunications carriers. The court held that the distinction did not violate the prohibition against "establish[ing] a classification of Internet access service providers . . . for purposes of establishing a higher tax rate on such providers than the tax rate generally applied to providers of similar information services delivered through other means."[14] The court reasoned that the exclusion was permissible because "[i]t is only in their capacity as public utilities or broadcasters that the telecommunications carriers or cable operators are permitted an exclusion."[15] As Joseph Bright observed in commenting on the *Concentric* opinion, however, "[i]f the federal statutes prohibit discrimination, it does not seem to be a sufficient justification that the discrimination is created by a second state statute."[16]

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[8] *See, e.g.*, Amy Hamilton, "MTC Digital Products Tax Project Puts ITFA Front and Center," *Tax Notes State*, Nov. 16, 2022, p. 679; Andrea Muse, "Litigation on Digital Taxes Raises ITFA Questions, Panel Says," *Tax Notes State*, Oct. 24, 2022, p. 326; and Muse, "Maryland Digital Ad Tax Ruling Applauded but Questions Remain," *Tax Notes State*, Oct. 19, 2022, p. 313.

[9] Needless to say, the article draws freely from our previous work in this area — in particular, Jerome R. Hellerstein, Walter Hellerstein, and Andrew Appleby, *State Taxation* (2022); Appleby, "Subnational Digital Services Taxation," 81 *Md. L. Rev.* 1 (2021); and Hellerstein, *supra* note 2.

[10] P.L. 105-277, section 1105(5)(A), Tit. XI, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[11] P.L. 108-435, section 2(c), 118 Stat. 2615, 2616 (2004). The provision now appears at P.L. 105-277, Tit. XI, section 1101(d)(3)(D), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[12] 932 A.2d 332 (Pa. Commw. 2007), *aff'd*, 942 A.2d 236 (Pa. Commw. 2008) (en banc), *aff'd per curiam*, 963 A.2d 903 (Pa. 2008).

[13] 877 A.2d 542 (Pa. Commw. 2005).

[14] P.L. 105-277, Tit. XI, section 1105(2)(A)(iv), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[15] *Concentric*, 877 A.2d at 549.

[16] Joseph C. Bright, "Court's Refund Denial on Internet Data Lines May Err on Federal Statute," *State Tax Notes*, July 4, 2005, p. 28.

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In an en banc decision dismissing the taxpayer's exceptions to the panel decision,[17] the court rejected the taxpayer's claim that the levy violated ITFA's bar against taxes on internet access, concluding that the Pennsylvania tax fell within the "grandfathering" clause preserving any tax that "was generally imposed and actually enforced prior to October 1, 1998."[18] The en banc court also reaffirmed the panel's decision that the tax did not violate the prohibition against establishing a higher tax rate on ISPs than the rate generally applied to providers of similar information services delivered through other means, because "the Tax Code does not classify information service providers, nor does it establish different tax rates on information services providers."[19] The court further observed:

> Moreover, Taxpayer pays sales and use tax because it uses other companies' wirelines to provide its services. Taxpayer is not prohibited by the Tax Code from installing its own wirelines or from using some other technology to provide its services. If it chooses an alternate solution, it will not pay sales and use tax on purchases of telecommunications services. In short, the tax at issue here results not from a discriminatory tax on electronic commerce but from Taxpayer's business decisions.[20]

2. The 2007 Amendments to the Definition of Internet Access

The 2007 ITFA amendments expanded the definition of internet access to include "a home page, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity,"[21] whether packaged with internet access or provided independently.[22] In *j2 Global Communications Inc. v. City of Los Angeles*,[23] a company (j2) that provided a fax-related service (eFax) enabling users to send and receive faxes through their email purchased "direct inward dial" (DID) telecommunications services, which allowed j2's customers to access its fax services. When someone sent a fax to a DID number that had been assigned to a j2 customer, the sender was initiating a telephone call that traveled over the public telephone lines to a fax card in one of j2's servers. After the j2 server received the incoming fax, the server converted it to a customer-specified format (such as a PDF) and sent the fax to the customer as an attachment to an email. J2 did not provide its customers with the services required to receive and access the email. J2 contended that tax was incorrectly imposed on its purchase of DID services because they constituted "Internet access" under subdivisions (A), (B), (C), and (E) of the definition quoted above.[24]

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[17] *Concentric Network Corp. v. Pennsylvania*, 897 A.2d 6 (Pa. Commw. 2006) (en banc), *aff'd per curiam*, 922 A.2d 883 (Pa. 2007).

[18] P.L. 105-277, Tit. XI, section 1104(a)(1), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note). The "grandfathering" generally expired June 30, 2020.

[19] *Concentric*, 897 A.2d at 15.

[20] *Id. But see Level 3 Communications LLC v. Pennsylvania*, 125 A.3d 832 (Pa. Commw. 2015) (service providing infrastructure, including local dial network, telephone numbers, and modems, for ISPs desiring to outsource remote access to their network or the internet constitutes internet access exempt from tax under Pennsylvania law (distinguishing *America Online* discussed earlier), *confirmed*, 151 A.3d 710 (Pa. Commw. 2016)), *aff'd per curiam*, 172 A.3d 1118 (Pa. 2017).

[21] Internet Tax Freedom Act Amendments Act of 2007, P.L. 110-108, section 4, 121 Stat. 1024 (2007). The provisions now appear at P.L. 105-277, Tit. XI, section 1105(5), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[22] The definition of internet access, as revised by the 2007 ITFA amendments, provides that internet access:

> (A) means a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet;
> (B) includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold
> (i) to provide such service; or
> (ii) to otherwise enable users to access content, information or other services offered over the Internet;
> (C) includes services that are incidental to the provision of the service described in subparagraph (A) when furnished to users as part of such service, such as a home page, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity;
> (D) does not include voice, audio or video programming, or other products and services (except services described in subparagraph (A), (B), (C), or (E)) that utilize Internet protocol or any successor protocol and for which there is a charge, regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E); and
> (E) includes a homepage, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access.

P.L. 105-277, Tit. XI, section 1105(5), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[23] 159 Cal. Rptr. 3d 742 (2d Dist. 2013).

[24] *See supra* note 22.

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The court rejected these contentions. Because j2 required its customers to obtain internet access services from third parties, it failed to establish that its eFax service qualified as internet access under subdivision (A). For the same reason, j2 could not establish that its eFax service qualified under subdivisions (B) or (C) because these provisions required that the service be purchased by one who either provides internet access under subdivision (A) or provides services that are "incidental to the provision of the service" described in subdivision (A), and j2 provided neither. Finally, the court rejected j2's contention that it was providing a "homepage" and "electronic mail" to its customers within the meaning of subdivision (E), because eFax users received faxes via email and accessed web-based email and the service's home page:

> [S]ending an email to an eFax customer through that customer's independently-obtained email service, and allowing customers to access their accounts through eFax's home page do not constitute providing a homepage or electronic mail service to the customers. If it did, virtually all business conducted over the Internet would be exempt from taxation. We decline to interpret subdivision . . . (E) in such a way as to render ITFA's definition of Internet access essentially meaningless.[25]

The Virginia tax commissioner ruled that a cellular service provider's offering of picture messaging that allowed users to take digital pictures and instantly send them to any other service-capable phone or email address while on the provider's network did not constitute "Internet access" within the meaning of ITFA.[26] As the commissioner's ruling explained:

> The Service does not give the customers access to the Internet as considered in the Act. In fact, the customers must already have access to the Internet in order to use the Service. The charges at issue are not for the monthly charge that subscribers pay for access to the Internet through ISPs; rather, the charges are for using the Service provided by the Taxpayer. Further, the Service is not the type of services that is considered to be incidental to the provision of Internet access as considered in the Act. The incidental services addressed in the Act are those that are provided to the customers as part of the Internet access account and are specifically excluded from the tax in the Act. Additionally, I find that the Service is not a type of e-mail or messaging as considered in the Act.[27]

The Colorado Department of Revenue ruled that ITFA's broadened definition of internet access preempted the application of the state's sales tax on "telephone and telegraph services" to "notification" or "production" email services.[28] These services enable customers to automate the creation and delivery of high volumes of outbound electronic messages by allowing messages uploaded by the customer to be delivered to multiple addresses and by allowing customized messages to be created and delivered to each individual recipient. In its rulings, the department observed:

> In 2007, Congress significantly expanded the scope of what was intended to be covered by the tax moratorium. First, the definition of "internet access" was expanded to include services deemed "incidental to" providing an internet connection, including a "home page,

[25] *j2 Global Communications*, 159 Cal. Rptr. 3d at, 748. *Accord J2 Cloud Services Inc. v. Commissioner*, No. C325426, Mass. App. Tax Bd. (Feb. 27, 2019); and Wash. Dep't of Revenue, Tax Determination No. 14-0307R, 38 WTD 29 (June 5, 2015).

[26] Virginia Department of Taxation, Ruling of the Tax Commissioner, Pub. Doc. No. 16-195 (Oct. 13, 2016).

[27] *Id. Cf.* Virginia Department of Taxation, Ruling of the Tax Commissioner, Pub. Doc. No. 18-209 (Dec. 18, 2018) (sustaining state's sales tax on communications services as to fees that allegedly were imposed solely for subscribers' ability to access the internet because ITFA "does not prohibit the Commonwealth from deeming the connectivity charges subject to the communications sales tax"); *accord* Virginia Department of Taxation, Pub. Doc. No. 15-217 (Dec. 8, 2015). *See also* Mo. DOR, Priv. Ltr. Rul. 5715 (June 16, 2009) (otherwise applicable sales tax on provision of T1 transport lines and dial modem ports to ISPs for carrying internet traffic is preempted by ITFA, as amended in 2007, because it includes telecommunications used by an ISP to provide internet services); and Mo. DOR, Priv. Ltr. Rul. 5594 (Apr. 20, 2009) (otherwise applicable sales tax on lease of broadband capacity to ISP is preempted by ITFA, as amended in 2007, because it includes telecommunications used by an ISP to provide internet services).

[28] Colo. DOR, Pvt. Ltr. Rul. PLR-15-003 (Feb. 4, 2015); and Colo. DOR, Pvt. Ltr. Rul. PLR-15-001 (Feb. 4, 2015).

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> electronic mail and instant messaging including voice- and video-capable electronic mail and instant messaging, video clips, and personal electronic storage capacity." More importantly, the 2007 act also provided that these types of "incidental" services were exempt from state taxation whether provided in connection with internet access services or not.
>
> The essence of this service is very similar to the ubiquitous email services of Google, Yahoo, and many other web-based providers. Users of such systems send data, including documents and image files, to recipients via the internet. If a customer were to customize each email and sent it individually to each desired recipient, any charges for those communications would not be subject to tax.[29]

Accordingly, the department concluded that the charges for notification email and production email could not be subject to tax.[30]

The 2007 amendments further excluded from the definition of tax on internet access taxes that Michigan, Ohio, and Texas imposed on gross receipts or gross income from business activity (in lieu of the typical state-level corporate income tax).[31]

3. The 'Grandfathering' Provisions

The original act grandfathered preexisting state taxes on internet access by excluding from ITFA's scope any tax that "was generally imposed and actually enforced prior to October 1, 1998."[32] Although that provision was extended through June 30, 2020, in conjunction with the 2016 legislation making ITFA permanent, a more limited grandfathering provision for states that were taxing the telecommunications services that were covered by the moratorium for the first time (that is, telecommunications services purchased, used, or sold to provide internet access) were grandfathered only through June 30, 2008.

The Virginia Supreme Court addressed the question whether a local business and professional occupational license (BPOL) tax imposed on internet access was preempted by ITFA or grandfathered.[33] The court first concluded that the tax fell within the scope of ITFA's "Internet access" definition, rejecting the county's argument that the BPOL was instead a "tax on business activity as measured by gross receipts."[34] The court then concluded that the tax was not grandfathered because it did not satisfy either of the two alternative bases for grandfathering. First, the county failed to provide "a reasonable opportunity to know, by virtue of a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof, that such agency has interpreted and applied such tax to Internet access services."[35] Second, the county failed to prove that it "generally imposed and actually enforced" the tax on internet access providers.[36] Thus, the court held that the tax was preempted by ITFA.[37]

C. Discriminatory Taxes on Electronic Commerce

The act's prohibition against discriminatory taxes on electronic commerce would have limited impact if it were restricted to that concept as it is generally understood, because historically it was rare for states to single out transactions in electronic commerce for invidious treatment.[38] However, Maryland's digital advertising tax,

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[29] *Id.*

[30] *Id. Accord* N.Y. Dep't of Tax'n and Fin., Op., TSB-A-20(30)S (July 14, 2020).

[31] Michigan later replaced its business tax, measured in part by gross receipts, with a more traditional corporate income tax. *See* Hellerstein, Hellerstein, and Appleby, *supra* note 9, para. 7.12[8].

[32] P.L. 105-277, Tit. XI, section 1101(a), 112 Stat. 2681 (1998).

[33] *Coxcom LLC v. Fairfax County*, 875 S.E.2d 75 (Va. 2022).

[34] *Id.* at 79.

[35] *Id.*

[36] *Id.* at 81.

[37] *Id.* at 81-82.

[38] One apparent exception to this generalization is reflected in *Alltel Communications LLC v. Montana Department of Revenue*, No. CDV-2010-981, First Judicial Dist. Ct. of Montana, Lewis and Clark Cty. (Feb. 22, 2012), in which a Montana trial court struck down a levy on receipts from Alltel's sale of games over the internet because "the sale of the same game from a seller that is not a provider of telecommunications services (*e.g.*, Wal-Mart) is not subject to the . . . tax." *Id.* The reason that the sale of the game from Walmart would not be taxed is that Montana is one of the few states without a retail sales tax. The fact that the levy applied to all telecommunications providers, a fact the Montana DOR thought was relevant, is plainly beside the point, because "'the determining factor under ITFA is not who sells the product, but whether similar sales that are not consummated via the Internet are taxed.'" *Id.*

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discussed below, potentially reflects a new trend of targeting novel electronic commerce business models for heightened taxation. Also, because Congress defined "discriminatory taxes" to include specific taxes in which a remote seller has only minimal nexus with a state, ITFA's bar on discriminatory taxes does have significant implications for state tax collection obligations.

1. Remote Seller's Out-of-State Server Does Not Create Nexus

Among other things, ITFA imposed restraints on the states' power to require remote sellers, which sell through electronic commerce, to collect use taxes on their internet sales. ITFA includes within its definition of prohibited "discriminatory taxes on electronic commerce"[39] two categories of taxes in which the seller's connection with the taxing state is, in Congress's view, insufficient to create a duty to collect.[40] First, Congress classified as "discriminatory" any tax (other than a grandfathered tax on internet access[41]) if the "sole ability to access a site on a remote seller's out-of-State computer server is considered a factor in determining a remote seller's tax collection obligation."[42] This, of course, is a minimum nexus provision, not an antidiscrimination provision. In substance, it forbids states from imposing taxes on internet sales by "remote" (that is, not physically present) sellers if the state relies on the purchaser's "sole ability" to access the seller's out-of-state computer server as a factor in determining whether the remote seller has nexus with the state and, consequently, an obligation to collect a tax on the transaction.

This nexus provision, however, contains a fundamental ambiguity: whether the critical phrase "a remote seller's *out-of-State* computer server" — which a state is barred from considering in determining the out-of-state seller's nexus with the state — should be read from the vantage point of the taxing state or the seller. If read from the perspective of the taxing state, which is the more natural reading, the provision is virtually meaningless. It would prevent a state from asserting nexus over an out-of-state internet seller if the state relied solely on the seller's computer server *in some other state* as a factor in considering whether the taxpayer had nexus in the taxing state. Even under the due process clause, it is doubtful whether the ability to access a remote party's computer server can in and of itself be a basis for asserting jurisdiction over that party.[43]

If the phrase "a remote seller's out-of-State computer server" is read from the standpoint of the seller, so that a state would be forbidden from imposing a use tax collection obligation on a remote internet seller based exclusively on the presence of the seller's server in the taxing state, then the provision would override those state laws, or administrative positions interpreting those laws, that rely on the seller's server in the state as nexus-creating in-state tangible personal property,[44] at least when the in-state server is the sole basis for the assertion of nexus. The significance of this protection has diminished significantly post-*Wayfair* because states may now assert nexus over internet sellers based on their economic presence in the state irrespective of the existence of an in-state server.[45]

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[39] P.L. 105-277, section 1101(a)(1), Tit. XI, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[40] This is a peculiar use of the word "discriminatory" since it does not carry with it the usual meaning of a tax that disfavors the particular activity in question (sales in electronic commerce) vis-à-vis competing activities (sales in conventional commerce).

[41] *See supra* Part II(B).

[42] P.L. 105-277, section 1105(2)(B)(i), Tit. XI, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note). Presumably, Congress intended this awkward phrase to mean "if the state relies solely on the purchaser's ability to access a site on a remote seller's out-of-state computer server." That is not, however, what Congress said, which creates a potential source of controversy.

[43] *See Cybersell Inc. v. Cybersell Inc.*, 130 F.3d 414 (9th Cir. 1997) (Arizona lacks minimum contacts sufficient to sustain jurisdiction over Florida firm that allegedly infringed service mark in advertisement placed on website but that neither encouraged nonresidents to use site nor generated business in Arizona via site); *Zippo Manufacturing Co. v. Zippo Dot Com Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997) ("A passive Web site that does little more than make information available to those who are interested in it is not grounds for the exercise of personal jurisdiction."); *but see Maritz Inc. v. Cybergold Inc.*, 947 F. Supp. 1328, 1333 (E.D. Mo. 1996) (sustaining personal jurisdiction in Missouri over California company, which posted information about new Internet service on a website in order to develop a mailing list of internet users, because Missouri users could access website and company "[t]hrough its Web site . . . has consciously decided to transmit advertising information to all internet users"); and *Inset Systems Inc. v. Instruction Set Inc.*, 937 F. Supp. 161, 165 (D. Conn. 1996) (sustaining personal jurisdiction over out-of-state advertiser whose website was accessible to in-state residents because "the [Internet] advertisement is available continuously to any Internet user"). *See generally* Arthur Rosen and Alysse Grossman, "Coping With Electronic Commerce Today," *State Tax Notes*, Feb. 9, 1998, p. 463.

[44] *See* Bloomberg Tax, "Nexus-Creating Activities: Sales and Use Tax — Internet Activities" (chart), *2022 Survey of State Tax Departments*, at 393-398.

[45] *See* Hellerstein, Hellerstein, and Appleby, *supra* note 9, para. 19.02[2][c].

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2. Internet Access Provider's Seller's Out-of-State Server Does Not Create Nexus

ITFA imposes a second nexus limitation (although couched as a limitation on "discriminatory taxes") on the states' ability to tax electronic commerce. ITFA prevents the states from claiming that they have nexus with a remote seller for purposes of requiring the remote seller to collect a use tax on its internet sales into the state by characterizing an internet access provider (for example, the telephone or cable company) as the remote seller's agent "solely as a result of (I) the display of a remote seller's information or content on the out-of-State computer server" of the internet access provider, or "(II) the processing of orders through the out-of-State computer server" of the internet access provider.[46]

This provision contains an ambiguity similar to that in the nexus provision described above: whether the "out-of-State computer server" — which a state is barred from considering in determining whether the internet access provider is the agent of the remote seller — should be viewed from the vantage point of the taxing state or the seller. For reasons set forth above, if the phrase is read from the perspective of the taxing state, which is the more natural reading, the provision is largely meaningless. It would prevent a state from asserting nexus over an out-of-state internet seller if the state relied solely on the internet access provider's computer server *in some other state* as a factor in considering whether the internet access provider was the remote seller's nexus-creating agent in the taxing state. States lack the power under existing constitutional restraints to require a remote seller to collect a tax in these circumstances.

If the phrase "*out-of-State* computer server" is read from the standpoint of the seller, it would prevent a state from asserting nexus over an out-of-state internet seller if the state relied solely on the internet access provider's computer server in the taxing state as a factor in considering whether the internet access provider was the remote seller's nexus-creating agent in the taxing state. Construed from this perspective, the provision essentially forbids the states from invoking an "attributional nexus" theory based solely on the remote seller's use of the internet access provider's in-state server.[47] The significance of this protection has diminished significantly post-*Wayfair*, however, because states may now assert nexus over internet sellers based on their economic presence in the state irrespective of the existence of an in-state server.[48]

3. Discriminatory 'Click-Through Nexus' Statutes

Many states enacted so-called click-through nexus statutes modeled after New York's "Amazon" law,[49] which imposed a use tax collection obligation on internet retailers that enlist in-state persons to refer customers to the retailer through links on their websites. Like New York, Illinois sought to impose such an obligation on internet retailers. Unlike New York, however, which imposed the obligation on sellers who enlisted a resident who, "for a commission or other consideration [. . .] refers potential customers, whether by a link on an internet website *or otherwise*, to the seller,"[50] Illinois made what turned out to be the fatal mistake of imposing its tax collection obligation only on "a retailer having a contract with a person located in this State, under which the person, for a commission or other consideration [. . .] refers potential customers to the retailer *by a link on the person's Internet website*."[51]

Relying on the fact that the Illinois statute targeted its tax collection obligation to retailers that enlisted those who referred customers to the retailers "by a link on the person's Internet

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[46] P.L. 105-277, section 1105(2)(B)(ii), Tit. XI, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[47] Though not citing ITFA, the Texas Comptroller of Public Accounts issued a private letter ruling that an out-of-state retailer whose in-state activity is limited to "(1) having ONLY a website on a third-party server in Texas (upon which the third-party provides all the functionality) and (2) delivering physical products into the state via third-party common carrier [is] not considered to be engaged in business in Texas." Tex. Comptroller of Public Accounts, Policy Ltr. Rul. 201103016L (Mar. 24, 2011) (capitalization in original).

[48] *See* Hellerstein, Hellerstein, and Appleby, *supra* note 9, para. 19.02[2][c].

[49] The New York law, and the litigation it spawned, are considered in detail in *id.* para. 19.04[2][a].

[50] N.Y. Tax Law section 1101(b)(8)(vi) (emphasis supplied). Also, the annual cumulative gross receipts from such referrals must exceed $10,000.

[51] 35 Ill. Comp. Stat. section 105/2 (prior law) (emphasis supplied). As in New York, the annual cumulative gross receipts from such referrals must exceed $10,000.

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website," the Illinois Supreme Court held in *Performance Marketing Association Inc. v. Hamer*[52] that the tax collection requirement violated ITFA's ban on discriminatory taxes. In particular, the court focused on the provision of ITFA defining a discriminatory tax as:

> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that —
>
> . . .
>
> (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.[53]

In the court's view, the plain language of ITFA branded Illinois's use tax collection obligation as discriminatory because it targeted out-of-state internet retailers that enter into agreements with internet affiliates for online "performance marketing" while imposing no such obligation on out-of-state retailers that enter into performance marketing contracts with "offline" Illinois print publishers and over-the-air broadcasters.

The Illinois DOR did not dispute the fact that the particular statutory language in question made no mention of traditional, "offline" performance marketing contracts but argued that the Illinois use tax collection provisions were not discriminatory when viewed more broadly because there were other statutory provisions that imposed a use tax collection obligation for offline performance marketing. The court rejected this argument:

> Under [. . .] the definition section of the Use Tax Act, retailers who enter into contracts with Illinois publishers and broadcasters for advertising "disseminated primarily to consumers located in this State," i.e., locally, are obligated to collect use tax. But Internet advertising is different. As the parties' joint stipulation of facts states: "The home page and other publicly-available pages of any Internet website can be accessed from a computer, or other digital device, located anywhere in the world that is connected to the Internet via wire or radio signal. Thus, information appearing on a webpage is available and *disseminated worldwide*." Illinois law does not presently require out-of-state retailers who enter into performance marketing contracts for "offline" print or broadcast advertising which is disseminated nationally, or internationally, to collect Illinois use tax. However, under the Act, out-of-state retailers who enter into such contracts with Illinois Internet affiliates for the publication of online marketing — which is inherently national or international in scope and disseminated to a national or international audience — are required to collect Illinois use tax. In this way, by singling out retailers with Internet performance marketing arrangements for use tax collection, the Act imposes discriminatory taxes within the meaning of the ITFA.[54]

Because the court resolved the issue under ITFA, it did not reach the commerce clause issues raised by the case.

Despite the significance of the general questions raised by click-through nexus statutes, we believe that there may be less than meets the eye to the Illinois Supreme Court's decision in *Performance Marketing*. The case ultimately turns on two narrow points of Illinois statutory law that easily could be — and in fact, have been[55] — changed to avoid the problem identified by the court with little or no practical effect. Thus, before the Illinois legislature actually amended the statute as described immediately below, we suggested the following statutory "fix":

> (1) inserting the phrase "or otherwise" after the phrase "refers potential customers to the retailer by a link on the

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[52] 998 N.E.2d 54 (Ill. 2013).

[53] P.L. 105-277, section 1105(2)(A)(iii), Tit. XI, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[54] *Performance Marketing*, 998 N.E.2d at 58-59 (emphasis in original).

[55] As described in the next paragraph.

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person's Internet website" in the statutory provision imposing a use tax collection obligation in connection with performance marketing arrangements; and

(2) broadening the phrase "disseminated primarily to consumers located in this State" by striking the world "primarily" and by inserting the phrase "and elsewhere" after "in this State" in the statutory provision imposing a use tax collection obligation in connection with "offline" marketing arrangements.

These statutory modifications would effectively address the aspects of the Illinois click-through nexus statute that troubled the Illinois court because, as a matter of substance, there would be no "singling out" of online retailers for use tax collection responsibilities. To the contrary, the overall thrust of the statute would be the creation of nondiscriminatory use tax collection obligations on all remote sellers making substantial sales into the state.[56]

In fact, the Illinois legislature modified the definition of a retailer subject to sales and use tax collection obligations (as reflected in the following italicized language) to:

> a retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by *providing to the potential customers a promotional code or other mechanism that allows the retailer to track purchases referred by such persons.*
>
> *Examples of mechanisms that allow the retailer to track purchases referred by such persons include but are not limited to the use of a link on the person's Internet website, promotional codes distributed through the person's hand-delivered or mailed material, and promotional codes distributed by the person through radio or other broadcast media.*[57]

4. Application of Business Gross Receipts and Sales Tax to Same Internet-Related Transaction

A Washington case addressed the question whether the application of both the state's business and occupation (B&O) tax and its retail sales tax[58] to the sale of "digital automated services" violated ITFA's rule barring taxes that discriminate against electronic commerce.[59] The taxpayer contended that if it "still sent Research reports to clients by mail or CD, as it once did," its sale of "digital automated services" would have been subject only to the B&O tax and that subjecting such services to both the B&O tax and the retail sales tax effectively "applied a higher tax rate only because its services are 'electronically transferred.'"[60] The taxpayer also invoked *Performance Marketing* (discussed above[61]) in support of its argument that Washington's tax regime violated ITFA "because it did not apply to the same activity if performed offline instead of online."[62] In rejecting the taxpayer's claim, the Washington Court of Appeals observed that the taxpayer's "sending its clients Research Content by e-mail is not the equivalent of . . . selling access to its Research Library."[63] Furthermore, access to the taxpayer's research library was "a digital automated service that is transferred electronically *and* uses one or more software applications."[64] Accordingly, the court concluded that the application of the retail sales tax to the taxpayer's automated digital service did not violate ITFA because it did not "single out"

[56] Indeed, one might even contend that, in its present form, the Illinois statute favors online performance marketers because of the $10,000 threshold of sales before the collection obligation arises.

[57] 35 Ill. Comp. Stat. section 105/2 (emphasis supplied).

[58] For a brief description of Washington's B&O tax (and its distinction from a retail sales and use tax), *see* Hellerstein, Hellerstein, and Appleby, *State Taxation*, *supra* note 9, para. 6.03[2][a][i].

[59] *Gartner Inc. v. Department of Revenue*, 455 P.3d 1179 (Wash. App. 2020). In this connection, it is worth observing that ITFA's prohibition of multiple taxation is directed at taxation of the "same or essentially the same electronic commerce" by two different states. *See infra* Part II(D).

[60] *Id.* at 1193.

[61] *See supra* Part II(C)(3).

[62] *Gartner*, 455 P.3d at 1192.

[63] *Id.* at 1193.

[64] *Id.* (emphasis in original).

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taxpayers that provide services via the internet.[65] Whether a digital service is "similar" to a traditional service for purposes of ITFA will likely be the source of considerable controversy as states increasingly focus on taxation of the digital economy, as discussed further in Part III.[66]

5. Digital Services Taxes

Digital services — most notably digital advertising services that extract and monetize user data — have attracted increasing attention from taxing jurisdictions because of the view that existing tax regimes may not sufficiently capture the profit generated by these new business models. In response to this concern at the international level, a number of countries have already adopted new digital services taxes, a development that has been the focus of considerable attention and generated considerable controversy.[67] In the U.S. subnational context, states confronting these issues are likewise searching for solutions that have likewise generated considerable controversy.[68] In 2021 Maryland was the first state to enact a digital advertising tax, which is similar to European digital services taxes.[69]

Under this new tax regime, Maryland imposes a tax "on annual gross revenues of a person derived from digital advertising services in the State."[70] The term "digital advertising services" includes "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services."[71] The tax rate is based on the taxpayer's "global annual gross revenues," and the applicable rate ranges from 2.5 percent for taxpayers with global annual gross revenue between $100 million and $1 billion to 10 percent for taxpayers with global annual gross revenue exceeding $15 billion.[72]

Almost immediately after Maryland enacted its digital advertising tax, taxpayers challenged the tax in both state and federal courts.[73] In the state court case, the Maryland Circuit Court for Anne Arundel County granted the taxpayers' motion for summary judgment, invalidating the digital advertising tax on several grounds, including ITFA preemption.[74] The written order provided no reasoning, instead simply declaring that the "Maryland Digital Advertising Gross Receipts Tax violates the Supremacy Clause of the United States Constitution and the Internet Tax Freedom Act because the Tax constitutes a discriminatory tax."[75] During the hearing preceding the order, however, the judge addressed the ITFA issue.[76] In finding that digital advertising is sufficiently similar to traditional advertising for ITFA purposes, the judge summarily declared: "Puppies are puppies and advertising is advertising."[77] In the federal case, the court dismissed the claim largely on the grounds that the Tax Injunction Act precluded the federal court's jurisdiction. Both cases are currently on appeal.

In the absence of an opinion examining the competing arguments addressed to the validity of the Maryland tax on the merits, we believe that the better part of valor for the moment is to refrain from attempting to determine the correctness of the state court's conclusion. There are viable arguments on both sides, however, that need to be analyzed in reaching that conclusion. The digital advertising business model differs in meaningful ways from traditional advertising. Digital

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[65] *See also* Wash. DOR, Administrative Review and Hearings Division, Determination No. 19-0284R (June 4, 2020) (determining that application of Washington's retail sales tax to a digital automated service, which included automated phone services, did not violate ITFA because there was not a similar non-digital service that was not subject to taxation).

[66] *See infra* Part II(C)(5) (discussing digital services taxes).

[67] *See* Arthur Cockfield, "Tax Wars: How to End the Conflict Over Taxing Global Digital Commerce," 17 *Berkeley Bus. L.J.* 347 (2020); Lilian Faulhaber, "Taxing Tech: The Future of Digital Taxation," 39 *Va. Tax Rev.* 145 (2019); and Ruth Mason and Leopoldo Parada, "The Legality of Digital Taxes in Europe," 40 *Va. Tax Rev.* 175 (2020).

[68] *See* Appleby, *supra* note 9; Hellerstein, Hellerstein, and Appleby, *supra* note 9, para. 4.19.

[69] Md. Code Ann., Tax-Gen. sections 7.5-101 et seq. (effective Jan. 1, 2022).

[70] *Id.* section 7.5-102(a).

[71] *Id.* section 7.5-101(e)(1).

[72] *Id.* section 7.5-103.

[73] *Comcast v. Comptroller of the Treasury*, No. C-02-CV-21-000509 (Md. Cir. Ct. Oct. 20, 2022); *Chamber of Commerce of United States v. Franchot*, No. 21-CV-00410-LKG (D. Md. Mar. 30, 2022).

[74] *Comcast v. Comptroller of the Treasury*, No. C-02-CV-21-000509 (Md. Cir. Ct. Oct. 20, 2022).

[75] *Id.*

[76] *See* Billy Hamilton, "In Maryland, Puppies Are Puppies and Ads Are Ads, Apparently," *Tax Notes State*, Oct. 31, 2022, p. 375.

[77] *Id.*

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advertisers collect and monetize user data by using that data precisely to target advertisements and to track their effectiveness in real time.[78] Indeed, the targeted nature of digital advertising, and thus its increased effectiveness, is why digital advertising providers can generate such enormous profits compared with the profits generated by traditional advertising providers. Although the state court's order shed little light on the important question of the degree of similarity required for ITFA preemption, future litigation will almost certainly do so.[79]

D. Multiple Taxes on Electronic Commerce

ITFA's prohibition of multiple taxation of electronic commerce is not a model of clarity. A "multiple tax" is defined as:

> any tax that is imposed by one State . . . on the same or essentially the same electronic commerce that is also subject to another tax imposed by another State . . . (whether or not at the same rate or on the same basis), without a credit (for example, a resale exemption certificate) for taxes paid in other jurisdictions.[80]

Congress excluded from this definition sales or use taxes imposed concurrently by a state and its political subdivisions on the same electronic commerce and "a tax on persons engaged in electronic commerce which may also have been subject to a sales or use tax thereon."[81]

Although one can discern Congress's objective in enacting this provision (namely, to prevent the same electronic commerce from being subject to tax by more than one state), the language that Congress chose to accomplish that goal is opaque at best.[82] While preventing more than one state from taxing "the same electronic commerce" might leave some room for debate, the prohibition of states taxing "essentially the same electronic commerce" is almost an invitation for controversy.[83] Indeed, it reads more like cocktail party conversation than a carefully thought out restraint on state taxing power.

Moreover, Congress apparently believes that two states can tax "the same" or "essentially the same" electronic commerce, even if the two levies are *not* imposed "on the same basis." Does this mean, for example, that Texas may not impose a sales or use tax on computer software transmitted via the internet from a Washington state software producer, because "essentially the same electronic commerce" was subject to Washington's B&O tax? Or is this the situation to which the "savings clause" was directed (that is, "a tax on persons engaged in electronic commerce"), which is not regarded as a multiple tax even if the same electronic commerce is subject to sales or use tax? If it is, however, the savings clause may defeat Congress's objective, because many state sales taxes are legally imposed on the vendor for the privilege of engaging in selling activities[84] (including, one would think, activities in electronic commerce). Hence, one could argue that duplicative sales or use taxation of electronic commerce is permissible as long as the legal incidence of one state's sales tax falls on the seller.

E. Bundled Services

The 2004 ITFA legislation addressed the thorny question of how one deals with sales of "bundled" services (that is, a bundle of services

[78] *See* Appleby, *supra* note 9, at 38.

[79] Indeed, it is likely that appellate courts in the Maryland case will address the ITFA similarity question, and it is possible that an appellate court would remand the case for further factual development that is arguably necessary to answer this question.

[80] P.L. 105-277, Tit. XI, section 1105(6)(A), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[81] *Id.* This exception to the "multiple tax" definition could be construed to exempt most sales and use taxes from the definition. The purpose of this exception, however, was much different, and such an interpretation would contradict legislative history and undermine the provision substantially. This exception originally addressed grandfathered taxes on internet access, which are no longer applicable, so the cross-reference was deleted, which resulted in this ambiguous and potentially misleading language.

[82] A congressional report provided an example of the intent underlying the multiple tax provision: "[A] resident of Virginia downloads a movie from a company based in Seattle while waiting at the airport in Chicago. Three states could claim the right to tax it; Virginia, Washington and Illinois. The statute . . . requires credits so the customer is not subject to three separate tax levies." H.R. Rep. No. 113-510, p. 3 (2014).

[83] *See, e.g.*, *City of Chicago v. StubHub! Inc.*, 624 F.3d 363, 366 (7th Cir. 2010) (arguably misinterpreting ITFA's multiple tax provision in favor of the state taxing authority).

[84] *See* Hellerstein, Hellerstein, and Appleby, *State Taxation*, *supra* note 9, para. 12.01; Walter Hellerstein, Michael McIntyre, and Richard Pomp, "Commerce Clause Restraints on State Taxation After *Jefferson Lines*," 51 *Tax L. Rev.* 47, 76 (1995); Appleby, *supra* note 9, p. 38.

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that is both taxable and exempt under ITFA) in the following provision:

> If charges for Internet access are aggregated with and not separately stated from charges for telecommunications services or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.[85]

This rule differs from the typical rule for bundled sales of taxable and nontaxable goods or services, which requires the vendor to state separately the charges for the respective components of the sale in order for them to receive separate treatment.[86] The "books and records" approach embodied in ITFA represented a victory for vendors over state tax administrators, who much prefer the "separate statement" rule because of concerns about ease of tax administration and audit. Vendors, however, find the separate statement rule burdensome and, perhaps more importantly, inconsistent with their business model of selling a seamless bundle of goods and/or services. Reminding purchasers that they owe tax on a portion of the bundle through the separate statement rule undermines the vendors' marketing objective.[87]

F. Taxes Versus Fees

For purposes of its prohibition on internet-related taxes, ITFA defines a tax as "any charge imposed by any governmental entity for the purpose of generating revenues for governmental purposes, and is not a fee imposed for a specific privilege, service, or benefit conferred."[88] In *Cox Communications Hampton Roads LLC v. City of Norfolk*,[89] Cox challenged the application of Norfolk's BPOL tax to its gross receipts from providing internet access services. In resisting the challenge, the city contended, among other things, that Norfolk's levy was a "fee" rather than a "tax" as defined by ITFA because "it is a charge for the specific privilege that entitles Cox to operate its personal and business services business within Norfolk's municipal boundaries.'"[90]

In a thoughtful opinion that canvassed a large body of case law addressing the tax-versus-fee distinction in a variety of contexts, the court rejected the city's contention:

> Whether viewed within the confines of the ITFA's statutory language or in terms of the well-established definitions of "tax" and "fee," the Court holds . . . that the BPOL Tax as applied to the gross receipts on Cox's internet access services is a tax and not a fee. . . . [T]he tax applies to "[e]very person engaging in the city in any business, trade, profession, occupation or calling." Nowhere does the City claim that it uses the BPOL Tax funds for anything other than general governmental purposes.[91]

G. ITFA's Application to Corporate Income Taxes

Although ITFA preemption issues arise most commonly in the context of transaction taxes or gross receipts taxes, ITFA's broad statutory language, discussed immediately above, encompasses corporate net income taxes as well. In *Expedia*, the New York State Department of Taxation and Finance attempted to use a market

[85] P.L. 108-435, section 4, section 18 Stat. 2615, 2617 (2004). The provision now appears at P.L. 105-277, Tit. XI, section 1106, 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[86] *See* Hellerstein, Hellerstein, and Appleby, *State Taxation*, *supra* note 9, paras. 17.01, 17.03.

[87] *See* Kan. DOR Priv. Ltr. Rul. 2011-003 (May 2, 2011) ("to ensure that the Internet access charge remains tax exempt, it is advised that your company list the Internet access charge separately on your customer's invoice and maintain business records to ensure that the costs associated with providing Internet access services are identifiable and reasonably established").

[88] P.L. 105-277, Tit. XI, section 1105(8)(A)(i), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note). ITFA's definition of a tax also includes "the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity." *Id.* ITFA provides an exception to its definition of a tax for "any franchise fee or similar fee imposed by a State or local franchising authority, pursuant to section 622 or section 653 of the Communications Act of 1934, or any other fee related to obligations or telecommunications carriers under the Communications Act of 1934." *Id.*

[89] No. CL19-4764, Va. Cir. Ct., 4th Cir. (Aug. 3, 2020).

[90] *Id.*

[91] *Id.*

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sourcing method for receipts from travel reservations booked over the internet but an origination sourcing method for receipts from travel reservation booked by traditional means.[92] The out-of-state taxpayer asserted that the department's position violated ITFA because it imposed a discriminatory tax on electronic commerce. The department's position resulted in greater tax liability for out-of-state taxpayers that provided their services over the internet rather than by traditional means. The taxpayer asserted, as required by ITFA, that these travel reservation services were sufficiently "similar," which is becoming an increasingly important determination, as discussed below. The New York State Division of Tax Appeals found in favor of the taxpayer but did so on a state statutory basis and declined to address the taxpayer's ITFA discrimination argument.[93]

H. Exceptions to ITFA When Access Provider Fails to Protect Minors From Harmful Content

Although it may have escaped the attention of most tax practitioners, ITFA provides exceptions from its protection against taxes on internet access when access providers fail to protect minors from harmful content. ITFA does not apply when a person or entity makes content "available to any minor . . . that includes any material that is harmful to minors unless such person or entity has restricted access by minors to material that is harmful to minors."[94] Similarly, ITFA does not apply:

> with respect to an Internet access provider, unless, at the time of entering into an agreement with a customer for the provision of Internet access services, such provider offers such customer (either for a fee or at no charge) screening software that is designed to permit the customer to limit access to material on the Internet that is harmful to minors.[95]

In *New Cingular Wireless PCS LLC v. Commissioner of Revenue*,[96] the Massachusetts Appeals Court considered the question whether ITFA preempted $20 million of sales taxes on internet access that New Cingular Wireless (an AT&T subsidiary) had collected from Massachusetts customers from 2005 to 2010. Following the settlement of a class action brought by AT&T's customers, under which AT&T agreed to stop collecting the taxes and to seek refunds that it would remit to customers after payment of attorney fees and administrative expenses, New Cingular brought suit in accordance with the settlement agreement. The Massachusetts commissioner of revenue resisted the suit on the grounds, among others, that the taxpayer had failed to comply with ITFA's "screening software" requirement and therefore was not protected by ITFA.

In addressing the question whether the taxpayer had complied with ITFA's screening software requirement, the court observed that a customer could obtain screening software from the taxpayer, and the taxpayer communicated this possibility to its customers through brochures, website pages, bill inserts, box inserts, and mailings. The court further observed that during some portions of the tax period, the iPhones for which the taxpayer was the exclusive access provider had built-in parental controls. Nevertheless, the court further noted that it was apparent that these features were not compatible with every device sold through and serviced by the taxpayer. Also, the taxpayer had no policy of requiring a salesperson to inquire specifically of each customer whether the customer wanted screening software at the time of purchase.

The commissioner contended that for a vendor to meet the statutory requirement that it "offer" the screening software, "it must affirmatively ask customers whether they would like the software."[97] In response, the court, while acknowledging that "this is one meaning of offer,"[98] continued that "[t]here . . . are, however,

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[92] *In re Expedia Inc.*, DTA Nos. 825025 and 825026 (N.Y.S. Div. Tax App. Feb. 5, 2015). In the interest of full disclosure, Andrew Appleby was counsel to the taxpayer in this matter.

[93] *Id.* at 19.

[94] P.L. 105-277, Tit. XI, section 1101(d)(1), 112 Stat. 2681 (1998), as amended, available at 47 U.S.C. section 151 (note).

[95] *Id.*

[96] 154 N.E.3d 947 (Mass. App. 2020).

[97] *Id.* at 956.

[98] *Id.*

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many other meanings, including 'to make available or accessible.'"[99]

> Here, the context informs the operative definition. The statute refers to the actions of a vendor. In that context, the latter definition is the most natural. It would be passing strange for one to assert that the local grocery store did not offer vegetables because, although it had an extensive vegetable section, no store employee asked the customer whether he wanted to purchase some vegetables.[100]

After considering other indicia of congressional intent, as well as the factual record of the taxpayer's efforts to provide information regarding "screening software," the court concluded that "the availability and advertising of screening software by the taxpayer complied with the screening software requirement of the ITFA."[101] Accordingly, the taxpayer had met its burden of proving that it offered screening software designed to permit its customers to limit access to material on the internet that is harmful to minors at the time of the taxed transactions in question, and ITFA preempted Massachusetts sales tax on the taxpayer's sale of internet access services.

III. Is ITFA Fit for Service in Today's Digital Economy?

We thought it would be appropriate to conclude our commemoration of ITFA's 25th birthday with a brief reflection on whether ITFA is fit for service in today's digital economy.[102]

When Congress was deciding in 2014 whether to make ITFA permanent, the House Judiciary Committee provided valuable insight into the original intent of ITFA and why at least some aspects of ITFA arguably had become antiquated.[103] ITFA's first operative provision, which prohibits taxes on internet access, is perhaps more important today than it was in 1998. Congress described the internet as "the greatest gateway to knowledge and self-help that has ever existed."[104] Removing barriers to internet access, particularly making it more affordable by exempting it from taxation, serves many governmental goals, including mitigating income inequality. Although states are permitted to tax other fundamental services, such as electricity and telephone services, ITFA's prohibition on internet access taxes is unambiguous, continues to serve its originally intended purpose, and is plainly fit for service in today's digital economy.

ITFA's second operative provision, however, arguably has outlived its originally intended purpose because it, perhaps with the assistance of ITFA, plainly has been achieved. The original intent of the discriminatory or multiple tax prohibition was to "foster the growth of electronic commerce."[105] That Congress included a sunset provision in the original ITFA, and then extended ITFA only reluctantly on multiple occasions until finally making it permanent in 2016, reflects ITFA's originally intended temporary nature.[106] In the 2014 debate over ITFA's status, those opposed to its extension stressed that ITFA was originally intended to incubate electronic commerce, not to provide an enduring advantage for electronic commerce over traditional commerce.[107] They observed that the "Internet is no longer a nascent development in need of Federal tax protection to grow. It is now a prosperous sector of the global economy."[108] They also noted that by 2014, "one of the original goals of the ITFA — to foster electronic commerce by protecting it from multiple and discriminatory taxation — has already been met as evidenced by the explosion of commercial transactions over the Internet."[109] They further contended that that ITFA's "electronic commerce" provision "will restrain the states' ability to cope with economic downturns" and "will burden taxpayers while

[99] *Id.* (citing Webster's *Third New International Dictionary*).

[100] *Id.*

[101] *Id.*

[102] The question whether one is "'fit for service' in today's digital economy" is one that the senior author of this article increasingly takes personally!

[103] H.R. Rep. No. 113-510, p. 5-10 (2014).

[104] *Id.* at 7.

[105] *Id.* at 17.

[106] *Id.* at 2-3.

[107] *See id.*

[108] *Id.* at 18.

[109] *Id.*

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excluding an entire industry from paying their fair share of taxes."[110] Nevertheless, in making ITFA permanent, Congress plainly rejected these arguments.

Assuming, as for the moment we must, that Congress continues to believe that electronic commerce needs heightened protection by making ITFA's second operative provision permanent, we strongly believe that Congress should clarify its intention by using language that is less ambiguous and more reflective of contemporary economic reality in which electronic commerce has continued its explosive growth. Alternatively, if Congress does not believe that electronic commerce merits legislative protection beyond what is already provided in the Constitution's commerce and equal protection clauses, it should repeal the portions of ITFA language that do not reflect its current intent. In this connection, it is worth noting that the *Comcast* order, which held that Maryland's digital advertising tax violated ITFA's second operative provision, also held that it violated the commerce clause.[111] One could view this conclusion as an indication that electronic commerce receives adequate protection under the commerce clause and that ITFA, with its inherently difficult "sufficiently similar" analysis discussed below, is unnecessarily duplicative.

Although there have been no serious efforts since 2016 to amend ITFA, Congress appears increasingly concerned with large technology companies' dominance, and it has been exploring various avenues to combat the effects of that dominance, including increased regulation and taxation. If Congress recognizes that the federal corporate net income tax does not adequately tax many of the key players in the digital economy, as Congress appeared to do when it enacted a corporate alternative minimum tax earlier this year, it arguably would be hypocritical to prohibit the states from undertaking their own efforts to tax the digital economy in a manner more consistent with contemporary economic reality. Because the role of the digital economy has expanded dramatically over the past 25 years, ITFA's second operative provision, as originally drafted, arguably has outlived its originally intended purpose and should be amended to reflect the 21st rather than the 20th century or be repealed.[112]

Wholly apart from the academic debates over ITFA's "fitness for service" in today's digital economy, it exists today as a powerful restriction on states' ability to tax the digital economy. Given ITFA's current language, the crucial inquiry in state digital taxation controversies is whether the activity effectuated through electronic commerce is sufficiently "similar" to an activity effectuated through traditional commerce. If so, and if the electronic commerce bears a greater incidence of taxation, the tax regime would violate ITFA.[113]

To date, few courts have fully considered ITFA's crucial sufficiently similar requirement. The Illinois Court of Appeals held that streaming services were not similar to live performances for purposes of ITFA, and suggested that ITFA applies only when the services are "identical."[114] The Washington Court of Appeals held that an online research library was not "equivalent" to research delivered by CD or email for purposes of ITFA.[115] As discussed earlier, the Maryland Circuit Court concluded that digital advertising *is* sufficiently similar to traditional advertising, without providing detailed reasoning.[116] The New York State Division of Tax Appeals declined to address whether travel reservations booked via the internet were sufficiently similar to those booked via traditional means.[117] Although some observers may disapprove of a fact-intensive analysis of whether activities are sufficiently similar because it "would just invite endless

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[110] *Id.* at 19.

[111] *Comcast v. Comptroller of the Treasury*, No. C-02-CV-21-000509 (Md. Cir. Ct. Oct. 20, 2022).

[112] *See, e.g.*, Dan R. Bucks et al., "Is It Time to Tax the Digital Economy?" *Tax Notes State*, Jan. 4, 2021, p. 29 (asserting that ITFA should be repealed in its entirety and that there may be political viability to do so).

[113] In such a case, the tax is likely to violate the commerce clause or equal protection clause as well.

[114] *Labell v. City of Chicago*, 147 N.E.3d 732, 747 (Ill. App. 1st 2019), *appeal denied*, 144 N.E.3d 1175 (Ill. 2020).

[115] *Gartner*, 455 P.3d at 1193.

[116] *Comcast v. Comptroller of the Treasury*, No. C-02-CV-21-000509 (Md. Cir. Ct. Oct. 20, 2022).

[117] *In re Expedia Inc.*, DTA Nos. 825025 and 825026 (N.Y.S. Div. Tax App. Feb. 5, 2015).

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litigation ad nauseam,"[118] in our view, ITFA requires such analysis.

Also, ITFA's imprecise drafting has allowed for creative arguments in favor of preemption. Apple asserted that Chicago's streaming video tax violated ITFA because it imposed tax on "video clips," which fall under ITFA's definition of internet access.[119] The case was settled before the court could consider this argument. Apple is also asserting that Texas cannot impose tax on its iCloud storage service because it qualifies as "personal electronic storage capacity" under ITFA.[120]

At the end of the day, the question whether ITFA is still fit for service is one that only Congress can definitively answer. Absent repeal, however, ITFA will continue to play an important — albeit unpredictable and controversial — role in state taxation of the digital economy. Happy birthday ITFA! ■

[118] Muse, *supra* note 8.

[119] *Apple Inc. v. City of Chicago* (No. 2018-L-050514) (Cook Cnty. Cir. Ct. July 20, 2022). *See also*, Muse, "Apple and Chicago Agree to Dismiss Streaming Tax Challenge," *Tax Notes State*, July 25, 2022, p. 453.

[120] *Apple Inc. v. Hegar*, No. D-1-GN-20-004108 (Tex. Dist. Ct. Travis Cnty. Aug. 7, 2020). *See also* Muse, "Litigation on Digital Taxes Raises ITFA Questions, Panel Says," *Tax Notes State*, Oct. 24, 2022, p. 326; Amy Hamilton, "Apple Tests New Approach to Internet Tax Freedom Act," *Tax Notes State*, Mar. 8, 2021, p. 1064.

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