TAPPING THE NETFLIX BINGE: CITIES BINGING ON TAXING STREAMING SERVICES VIOLATE FEDERAL LAW

*Genna Autumn Conti**

"Internet access drives innovation and the success of our economy. It is a gateway to knowledge, opportunity, and the rest of the world."[1]

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1. Press Release, Beth Breeding, Comm. Dir. for Representative Bob Goodlatte, House Passes Permanent Internet Tax Freedom Act (June 9, 2015), http://goodlatte.house.gov/news/documentsingle.aspx?DocumentID=356.

I. INTRODUCTION

A. Overview

On October 21, 1998, President Bill Clinton signed the Internet Tax Freedom Act ("ITFA"), part of the Omnibus Consolidated and

Emergency Supplemental Appropriations Act.[2] Originally, Congress discussed several bills.[3] These bills shared a common purpose: to "regulate state and local taxation of the Internet."[4] Although the bills all had the same intention, they differed in the following respects: (1) when the moratorium would expire; (2) which portions of the Internet could and could not be taxed; (3) which taxes would be permissible and which taxes would be prohibited; (4) whether taxes on the Internet already in effect would be grandfathered into the bill; (5) "the focus of the consultative group or commission;" (6) who would serve as members of the committee; and (7) "what policy actions [would be] expected at the end of the moratorium."[5] Eventually, Congress chose to enact ITFA.[6]

The primary purpose of enacting ITFA was to develop a uniform policy that would allow state and local governments to tax Internet access, while still allowing the Internet to develop and grow.[7] As stated by Congressman Cox, who introduced ITFA, "[t]he Internet Tax Freedom Act is based on a simple principle: Information should not be

2. Internet Tax Freedom Act (ITFA), 47 U.S.C. § 151 (2012). ITFA is part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, which addresses various issues such as agriculture, AIDS, ocean mining, patents, and a moratorium on internet taxes. Omnibus Consolidated and Emergency Supplemental Appropriations Act (OCESAA), Pub. L. No. 105-277, 112 Stat. 2681 (1998); Kelly Phillips Erb, *Will Congress Keep the Internet Tax Free?*, FORBES (June 20, 2014, 10:18 AM), http://www.forbes.com/sites/kellyphillipserb/2014/06/20/will-congress-keep-the-internet-tax-free/.

3. The other bills were H.R. 1054 and S. 442, which were introduced in March 1997. NONNA A. NOTO, CONG. RESEARCH SERV., INTERNET TAX BILLS IN THE 105TH CONGRESS 85 (1998). In the spring of 1998, H.R. 3529 and H.R. 3849 were introduced in place of H.R. 1054 and S. 442. *Id.*

4. *Id.*

5. *Id.* at 86. There were four groups who debated the focus of the bills: (1) "the Internet business community;" (2) "the Clinton Administration;" (3) "state and local revenue officials;" and (4) "competing sectors of the economy subject to tax." *Id.* The Internet business community's concerns were that states would impose discriminatory taxes on the Internet, and the Internet would be subjected to multiple taxation. *Id.* The Clinton Administration was concerned with America's economic growth, promoting economic commerce in America, and international trade. *Id.* at 87. State and local revenue officials were apprehensive they would lose the authority to govern and regulate their own taxes. *Id.* Competing sectors of the economy subject to tax were worried they would lose revenue to business not subject to taxes over the Internet. *Id.*

6. *See* Internet Tax Freedom Act (IFTA), 47 U.S.C. § 151 (2012).

7. Timothy Fallaw, *The Internet Tax Freedom Act: Necessary Protection or Deferral of the Problem?*, 7 J. INTELL. PROP. L. 161, 161 (1999).

taxed."[8] Accordingly, ITFA prevented the Internet from being taxed by state and local governments during its formation period.[9]

ITFA fostered the growth of the Internet and helped it become a part of everyday life, allowing Americans to communicate globally and gain access to almost any good or service, including the "cloud"[10] and streaming[11] services, from virtually anywhere, through the use of devices such as computers, phones and tablets.[12] ITFA's legislative history evidences Congress' intent for the Internet to remain tax-free. Congress expanded ITFA's end date multiple times, and attempted to make ITFA permanent through legislative proposals such as the Permanent Tax Freedom Act and the Internet Tax Freedom Forever Act.[13] In December 2015, "the Senate appended the text of what had

8. H.R. REP. NO. 105-570, pt. 1, at 29 (1998).

9. IFTA § 203(a) ("It is the sense of Congress that the President should seek bilateral, regional, and multilateral agreements to remove barriers to global electronic commerce."); Fallaw, *supra* note 7, at 161.

10. Cloud computing has in the past been defined as "a broad range of services that allow users to store their data and applications on remote computers." Elijah Yip & Martin E. Hsia, *Confidentiality in the Cloud: The Ethics of Using Cloud Services in the Practice of Law*, 31 COMPUTER & INTERNET L. 1, 1–2 (2014). This means that information and applications stored on the cloud "can be accessed anywhere the user and an Internet connection including a home computer, work computer, laptop, smartphone, or tablet." *Id.* at 2. The National Institute of Standards and Technology ("NIST"), in an attempt to provide a consistent definition of "cloud computing," has drafted that "cloud computing" is "a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or services provider interaction." JENNIFER JENSEN, PWC, HOW DOES ONE TAX THE CLOUD? 2 (2012), http://www.pwc.com/us/en/state-local-tax/assets/pwc-how-does-one-tax-the-cloud.pdf. According to NIST, the five main characteristics of cloud computing are (1) "[o]n-demand self-service," (2) "[b]road network access," (3) "[r]esource pooling," (4) "[r]apid elasticity," and (5) "[m]easured service. *Id.*

11. Streaming is defined as "[a] method of transmitting or receiving data (especially video and audio material) over a computer network as a steady, continuous flow, allowing playback to proceed while subsequent data is being received." *Streaming*, OXFORD DICTIONARY, http://www.oxforddictionaries.com/us/definition/american_english/streaming (last visited Feb. 4, 2018). "In streaming video and audio, the traveling information is a stream of data from a server. The decoder is a stand-alone player or a plugin that works as part of a Web browser. The server, information stream and decoder work together." Tracy V. Wilson, *How Streaming Video and Audio Work*, HOW STUFF WORKS: TECH (Oct. 12, 2007), http://computer.howstuffworks.com/internet/basics/streaming-video-and-audio.htm.

12. *See* Fallaw, *supra* note 7, at 162.

13. *See* Continuing Appropriations Act, Pub. L. No. 114-53, § 127, 129 Stat. 502, 509 (2015); Permanent Tax Freedom Act, H.R. 235, 114th Cong. (as passed by the House of Representatives, June 9, 2015); Internet Tax Freedom Forever Act, S. 431, 114th Cong. (as assigned to a congressional committee, Feb. 10, 2015); JEFFREY M. STUPAK, CONG. RESEARCH SERV., THE INTERNET TAX FREEDOM ACT: IN BRIEF 1 (2016).

been the Permanent Internet Tax Freedom Act onto a much more pressing legislative matter—HR 644, the Trade Facilitation and Trade Enforcement Act of 2015."[14] The Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA) was signed into law on February 24, 2016, by President Obama, finally ensuring ITFA's permanency.[15]

Nevertheless, in an attempt to generate additional revenue, various cities have attempted to bypass ITFA and tax Internet access.[16] For example, Pasadena, California's "finance department decided . . . to apply a 9.4 percent tax on 'video services' to subscribers of streaming video providers" beginning January 1, 2017, by expanding an existing municipal utility tax.[17] Additionally, Chicago, Illinois, has recently expanded an already existing amusement tax to include Internet access.[18] Various users of online video, gaming and music streaming services have filed a lawsuit, *Labell v. City of Chicago*, alleging that Chicago's expanded amusement tax violates ITFA.[19] As Pasadena's tax just went into effect on January 1, 2017, no lawsuit has yet been filed in California.[20] The suit in Chicago, however, could be influential, if not dispositive, on the Pasadena law.[21] Ultimately, the Court in *Labell v. City of Chicago* should hold that Chicago's expanded amusement tax violates ITFA and the U.S. Constitution. Chicago attempted to overstep ITFA by expanding its already existing 9% amusement tax to include streaming services, instead of creating a new statute, which would violate ITFA and the Constitution.[22]

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14. Chris Morran, *President Signs Bill Making Internet Service Tax Ban Permanent*, CONSUMERIST (Feb. 24, 2016), https://consumerist.com/2016/02/24/president-signs-bill-making-internet-service-tax-ban-permanent. The amendment itself is rather simple. It removes the end date on the existing tax ban, thereby making it permanent. Additionally, it establishes an end date of June 30, 2020 for those few states—Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Texas, and Wisconsin—that are still collecting sales taxes on Internet services. *Id.*

15. *Id.*

16. Matthew Adam Susson, *Thinking Out Cloud: California State Sales and Use Taxability of Cloud Computing Transactions*, 17 CHAP. L. REV. 295, 295 (2013).

17. Jason Henry, *Pasadena Will Tax Netflix, Hulu and Your City Might Be Next*, PASADENA STAR-NEWS (Sept. 23, 2016, 5:08 PM), http://www.pasadenastarnews.com/government-and-politics/20160923/pasadena-will-tax-netflix-hulu-and-your-city-might-be-next.

18. *See* CHI., ILL., MUN. CODE § 4-156-020 (1990); City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5, (June 9, 2015), http://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/AmusementTaxRuling5-06092015.pdf; Susson, *supra* note 16, at 295.

19. Labell v. City of Chicago, LIBERTY JUST. CTR., http://libertyjusticecenter.org/cases/labell-v-city-of-chicago/#background (last visited Feb. 4, 2018) [hereinafter *Labell*, LJC].

20. *See* discussion *infra* Part V.

21. *See* discussion *infra* Parts V, VI.

22. *See* discussion *infra* Part VI.

The purpose of this Note is to prove the invalidity of Chicago's 9% amusement tax, Pasadena's 9.4% tax, and similarly enacted taxes as applied to Internet usage. Thus, Part II of this Note will contain a brief history of the growth of the Internet; Part III will provide an overview and explanation of ITFA; Part IV will discuss Chicago's 9% amusement tax and Pasadena's 9.4% utility tax; Part V will review the proceedings in *Labell v. City of Chicago*; Part VI will provide an analysis for how the court should decide the federal issues presented in *Labell v. City of Chicago* and similar lawsuits that may be filed; Part VII will discuss additional constitutional arguments that could have been made in the Complaint of *Labell v. City of Chicago*; Part VIII will assess policy considerations for continuing to keep the Internet tax free and the implications of inconsistent judgments that find these taxes are valid, and Part IX will conclude this Note.

II. AN OVERVIEW OF THE HISTORY AND USAGE OF THE INTERNET

A. History of the Internet

Because the Internet is constantly changing, it is important to discuss how rapidly the Internet has grown since its development and how integral the Internet is to daily American life and commerce. The Internet's predecessor, created in the 1960s by the U.S. Department of Defenses Advanced Research Projects Agency (ARPA), was called the ARPANET.[23] The biggest success of ARPANET was that it linked together multiple computers.[24] Funding for the development of computers and research came primarily through ARPA.[25] J.C.R. Licklider, who worked at the Massachusetts Institute of Technology (MIT), developed the concept of a Galactic Network, by which computers could communicate with each other.[26] Another scientist from MIT developed an alternative method, through which computers could

23. *History of the Internet*, NEW MEDIA INST. (2014), http://www.newmedia.org/history-of-the-internet.html (last visited June 1, 2017).

24. *Id.*

25. *Id.* ARPA funded the development of ARPANET and computers because ARPA wanted to "develop a survivable communication structure in the event of nuclear attack" for the U.S. Military. *Id.* The U.S. Military was concerned about the destruction of the United States' telephone systems, eliminating the ability to communicate with people not in the immediate proximity, if the Soviet Union decided to attack the United States by nuclear missile. *The Invention of the Internet*, HISTORY, http://www.history.com/topics/inventions/invention-of-the-internet (last visited Feb. 4, 2018). Thus, the creation of the "galactic network" would allow long-distance communication to persist even if a nuclear missile destroyed the United States' telephone lines. *Id.*

26. *The Invention of the Internet*, *supra* note 25.

communicate with each other, the "packet switching" method.[27] The "packet switching" method "breaks data down into blocks, or packets, before sending it to its destination."[28] The packet switching method was ultimately chosen to facilitate computer communication in ARPANET.[29] In 1969, the first message was sent through ARPANET, crashing the ARPA network.[30] At that time, only "four computers were connected to the ARPA[NET],"[31] but in the 1970s, the network grew.[32] As the number of computers that joined ARPANET's packet switching computer network grew, the more difficult it became to create one system that could support all of the computers.[33]

In 1973, Robert Kahn and Vinton Cerf solved this problem by inventing the "Transmission Control Protocol/Internet Protocol" ("TCP/IP").[34] TCP/IP created a way for all of the computers on "mini-networks" to join one larger network that communicated together.[35] Additionally, TCP/IP solved the crashing issue posed by the "packet switching" method, by allowing each network to work independently, so if one network in the system stopped functioning, the other networks in the system continued to work.[36] TCP/IP successfully transformed computers into one global network, enabling user files and data to be transferred from one computer to another.[37] The TCP/IP protocol was used throughout the 1980s.[38]

In addition to the development of a global network, the 1970s also brought the first commercially available computer for personal use, the Altair 8800.[39] In the mid-1970s, Steve Jobs and Steve Wozniak founded Apple Computer and, two years later, released the Apple II, the "first

27. *Id.*

28. *Id.*

29. *Id.* Packet switching was less vulnerable than the Galactic Network, which "would have been just as vulnerable to enemy attacks as the phone system." *Id.*

30. *Id.* The first message was "LOGIN." *Id.* The message was sent from a computer in a research lab at UCLA to a computer at Stanford. *Id.* The computer at Stanford only received the first two letters of the message. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *History of the Internet – 1970s*, NEW MEDIA INST. (2014), http://www.newmedia.org/history-of-the-internet.html?page=2. Vinton Cerf later added a protocol to the "Transmission Control Protocol" called the "Internet Protocol," now referred to as TCP/IP. *The Invention of the Internet*, *supra* note 25.

35. *The Invention of the Internet*, *supra* note 25; *History of the Internet – 1970s*, *supra* note 34.

36. *History of the Internet – 1970s*, *supra* note 34.

37. *The Invention of the Internet*, *supra* note 25.

38. *Id.*

39. *History of the Internet – 1970s*, *supra* note 34.

mass-marketed personal computer."[40] These inventions helped bring computers into home offices and integrate the Internet into everyday life.

In the following decades, two key inventions enabled the connectivity necessary for the Internet we know today. In the 1980s, Dave Farber developed a computer network that used dial-up phones to connect the computers.[41] In 1991, Tim Berners-Lee, a Swiss computer programmer, created the "World Wide Web."[42] The "World Wide Web" not only allows files and data to be transferred from one computer to another, but is also "a 'web' of information that anyone on the Internet c[an] retrieve."[43]

Since the development of the World Wide Web, the advancements of the Internet have been even more rapid. The first Web browser, Mosaic,[44] was created in 1992, allowing Internet users to view text and pictures together, and to use scrollbars and links to navigate the Internet.[45] In 1992, Congress announced the Internet could be used commercially, which created the start of e-commerce, allowing individuals and business to sell goods through the Internet.[46] Most recently, social media websites, such as Facebook, Twitter, and Instagram, have been developed, allowing individuals to share information and stay connected.[47] The development of e-commerce and streaming services created the issue that will be discussed in this Note—taxation of Internet usage.

B. The Internet: Then and Now

Since 2000, the Internet usage rate in the United States has almost doubled.[48] Approximately 44% of the American population used the Internet in 2000.[49] As of 2014, approximately 87% of the American population uses the Internet.[50] Thanks to the development and

40. *Id.*

41. *History of the Internet – 1980s*, NEW MEDIA INST., http://www.newmedia.org/history-of-the-internet.html (last visited June 1, 2017).

42. *The Invention of the Internet*, *supra* note 25.

43. *Id.*

44. Mosaic was developed by students and researchers at the University of Illinois. *Id.* Mosaic later became Netscape. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *See United States of America Internet Usage and Broadband Usage Report*, INTERNET WORLD STATS., http://www.internetworldstats.com/am/us.htm (last visited June 1, 2017).

49. *Id.*

50. *Id.*

expansion of the Internet, ITFA, and the inability to tax Internet access, not only has the Internet become a substantial profit-driven industry in America, but it has also become a foundation for global trade.[51]

However, after almost seventy years of tax-free Internet access, cities, such as Chicago and Pasadena, have attempted to tax Internet access in order to generate additional revenue. Although this tax may generate revenue for states and localities, it is unclear what negative effects on Internet usage and the economy such taxes would have.

III. THE INTERNET TAX FREEDOM ACT

ITFA contains two main components: (1) a moratorium, and (2) the establishment of an advisory commission on electronic commerce.[52] Through a declaration in ITFA, Congress definitively stated its intent when creating ITFA was "that no new Federal taxes . . . should be enacted with respect to the Internet and Internet access during the moratorium . . . ."[53] The moratorium announces that "[n]o State or political subdivision thereof shall impose . . . during the period beginning on October 1, 1998, and ending 3 years after the date of the enactment of this Act . . . (1) taxes on Internet access"[54] and "(2) multiple or discriminatory taxes[55] on electronic commerce."[56] Although

51. *See* ORG. FOR ECON. COOPERATION & DEV., OECD INTERNET ECONOMY OUTLOOK 2012 2 (2012), http://www.oecd.org/sti/ieconomy/internet-economy-outlook-2012-highlights.pdf.

52. *See* ITFA, Pub. L. No. 105–277, §§ 1100–02, 112 Stat. 2681–719 (1998). Although not at issue in this Note, the purpose of the advisory committee was to "conduct a thorough study of Federal, State and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate or international sales activities." *Id.* § 1102(g)(1).

53. *Id.* § 1201.

54. *Id.* § 1101(a)–(a)(i). ITFA originally defined Internet access as "a service that enables users to access content, information, electronic mail, or other services offered over the Internet." *Id.* § 1104(5). The Internet Tax Nondiscrimination Act extended Internet access to include digital subscriber line (DSL), as some states argued that DSL was exempt from ITFA since it was a telecommunication service. STEVEN MAGUIRE, CONG. RESEARCH SERV., INTERNET TAXATION (2004), https://ipmall.law.unh.edu/sites/default/files/hosted_resources/crs/EBTXR70_040430.pdf (last updated Apr. 30, 2004); *see also* Internet Tax Nondiscrimination Act, Pub. L. No. 107–75, § 1, 115 Stat. 703 (2001).

55. The Internet Tax Freedom Act defines a discriminatory tax as:

> "(A) any tax imposed by a State or political subdivision thereof on electronic commerce that—(i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or

ITFA bans "taxes on Internet access," it grandfathers in any taxes on Internet access "generally imposed and actually enforced prior to October 1, 1998," allowing these taxes to remain intact and enforceable by those cities and states even after ITFA became effective.[57] Originally, ITFA was not permanent, and Congress had to renew it eight times.[58] Finally, on February 24, 2016, TFTEA was signed into law, making ITFA permanent and creating an end date to the grandfather clause, June 30, 2020.[59] The text of Section 922, "Permanent Moratorium on Internet Access Taxes and on Multiple and Discriminatory Taxes on Electronic Commerce" states:

> (a) Permanent Moratorium.—Section 1101(a) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking 'during the period beginning November 1, 2003, and ending October 1, 2015'.
>
> (b) Temporary Extension.—Section 1104(a)(2)(A) of the Internet Tax Freedom Act (47 U.S.C. 151 note) is amended by striking 'October 1, 2015' and inserting 'June 30, 2020'.[60]

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information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period; (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 . . . ."

ITFA, Pub. L. No. 105–277, § 1104(2)(A)(i)–(iii), 112 Stat. 2681–719 (1998).

56. *Id.* § 1101(a)(2). ITFA does not apply to sales tax. *Id.* §§ 1104(6)(B)–(C). Congress believed that this clause was necessary because "[t]he Internet Tax Freedom Act is needed not just to give the Net room and time to grow," but also because "the Net is inherently susceptible to multiple and discriminatory taxation in a way that commerce conducted in more traditional ways is not." H.R. REP. NO. 105-570, pt. 1, at 27 (1998). For example, Congress believed states and cities would try to tax singular Internet transactions. *Id.*

57. ITFA § 1101(a)(1).

58. Kelly Phillips Erb, *Congress Makes Internet Access Tax Ban Permanent*, FORBES (Feb. 11, 2016, 6:20 PM), http://www.forbes.com/sites/kellyphillipserb/2016/02/11/congress-makes-internet-access-tax-ban-permanent/#2bebbbb5380a. "To keep the moratorium in place, Congress had to extend it. And extend it again. So they did so in 2001, 2004, 2007 and 2014 and a series of band-aids through 2015—eight times in total." *Id.*; *see also* Consolidated Appropriations Act, Pub. L. No. 114-113, § 633, 129 Stat. 2471 (2015); *Internet Tax Freedom Act Extended Through October 1, 2016*, SALES TAX INST., (Jan. 18, 2016), http://www.salestaxinstitute.com/resources/news/internet-tax-freedom-act-extended-through-october-1-2016; STUPAK, *supra* note 13, at 1.

59. Trade Facilitation and Trade Enforcement Act of 2015, Pub L. No. 114-125, § 922, 130 Stat. 122.

60. *Id.*

Along with the eight extensions to the end date of ITFA, which were eventually made permanent, the grandfather clause and the definition of Internet access were modified as technology developed.[61] Originally, thirteen states imposed taxes on Internet access that were grandfathered in by ITFA, but Illinois was not one of them.[62] The Internet Tax Freedom Act Amendments Act of 2007 modified the grandfather clause, which "revoked grandfather protections if states had voluntarily repealed their Internet access taxes since the passage of ITFA in 1998."[63] Six states voluntarily eliminated their taxes and, therefore, only seven states currently impose a tax on Internet access under ITFA's grandfather clause.[64] As per Section 922 of the Trade Facilitation and Trade Enforcement Act of 2015, these states must end their taxes on or before June 30, 2020.[65]

Prior to the passage of the TFTEA, the road to ITFA's permanency was not an easy one, as Congress asserted multiple failed efforts to keep the Internet permanently tax-free.[66] "There had been various legislative attempts to make the ban permanent over the years, but they either got bogged down by partisan politics or caught up in the controversial debate about online sales tax collection."[67] On January 9, 2015, the House of Representatives introduced the Permanent Internet Tax Freedom Act,[68] which proposed to permanently extend ITFA and eliminate the grandfather clause.[69] On February 10, 2015, a second

61. STUPAK, *supra* note 13, at 2–3.

62. *Id.*

63. *Id.* at 1; Internet Tax Freedom Act Amendments Act of 2007, H.R. 3678, 110th Cong. (2007). "Unlike the 2007 grandfather, the 2005 grandfather required both an acknowledgement by public rule or proclamation that Internet access was subject to tax *and* that the state generally collected the tax." JAMES P. KRATOCHVILL & PILAR M. SANSONE, TAX ANALYSTS, TOO MANY GRANDFATHERS SPOIL THE BROTH: THE FAILURE OF THE INTERNET TAX NONDISCRIMINATION ACT? 33 (2007).

64. STUPAK, *supra* note 13, at 3 (citations omitted). The seven states currently grandfathered into ITFA and are able to tax Internet access are Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Texas, and Wisconsin. *Id.* These states collect $563 million per year combined through taxing Internet access. *Id.* The original states were Connecticut, Wisconsin, Iowa, North Dakota, South Dakota, New Mexico, South Carolina, Tennessee, Texas, and Ohio. KRATOCHVILL & SANSONE, *supra* note 63, at 30.

65. Trade Facilitation and Trade Enforcement Act of 2015, Pub L. No. 114-125, § 922(b), 130 Stat. 122.

66. *Id.*; Morran, *supra* note 14.

67. Morran, *supra* note 14.

68. Permanent Tax Freedom Act, H.R. 235, 114th Cong. (as passed by House of Representatives, June 9, 2015).

69. The Permanent Tax Freedom Act, which would keep the Internet from being taxed forever, posed problems, which stopped Congress from passing it. *See* Erb, *supra* note 2; *infra* Section VI. The Permanent Tax Freedom Act would invalidate any taxation made prior to ITFA, which was previously grandfathered in. Erb, *supra* note 2. If

bill, the Internet Tax Freedom Forever Act, was referred to a congressional committee.[70] However, other than being read in the Senate, the Internet Tax Freedom Forever Act did not progress.[71] Although the Internet Tax Freedom Forever Act had essentially the same effect as the Permanent Internet Tax Freedom Act, the Permanent Internet Tax Freedom Act was more likely to pass.[72] Eventually, the Permanent Internet Tax Freedom Act was consolidated into TFTEA and became law.[73]

IV. CHICAGO'S AMUSEMENT TAX & PASADENA'S UTILITY TAX

A. Chicago's Amusement Tax

1. Amusement Tax

The City of Chicago's Municipal Code includes an amusement tax, which states that, unless exempted, "an amusement tax is imposed upon the patrons of every amusement within the city. The rate of the tax shall be equal to nine percent of the admission fees or other charges paid for the privilege to enter, to witness, to view or to participate in such amusement . . . ."[74] Under Chicago's Municipal Code, the definition of "amusement" is:

Congress passed the Permanent Tax Freedom Act, then Congress may have overstepped its boundaries by taking away a source of funding from these states originally grandfathered into ITFA. Morran, *supra* note 14.

70. Internet Tax Freedom Forever Act, S. 431, 114th Cong. (as assigned to a congressional committee, Feb. 10, 2015). The bill is sponsored by John Thune, a Senior Senator from South Dakota. *Id.*

71. Internet Tax Freedom Forever Act, S. 431, 114th Cong. (2015).

72. The substantial difference between the Permanent Internet Tax Freedom Act and the Internet Tax Freedom Forever Act is that the Internet Tax Freedom Forever Act contains a set of findings, whereas the Permanent Internet Tax Freedom Act does not. *Compare* Internet Tax Freedom Forever Act, S. 431, 114th Cong. (2015), *with* H.R. 235, 114th Cong. (2015); *Permanent Internet Tax Freedom Act,* GOVTRACK, https://www.govtrack.us/congress/bills/114/hr235 (last visited Feb. 4, 2018). The Internet Tax Freedom Forever Act had only approximately an 8% chance of being passed, whereas the Permanent Internet Tax Freedom Act had approximately a 15% chance of being enacted. *Compare* S. 431, *with* H.R. 235.

73. Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 122. The Trade Facilitation and Trade Enforcement Act of 2015 does not make any mention of the online tax sales collection issue, which is still a problem Congress must address.

74. CHI., ILL., MUN. CODE § 4-156-020(A) (1990). Exemptions to Chicago's amusement tax include "automatic amusement machines," "stock show[s] or . . . business show[s] . . . not open to the general public," "hiring a horse-drawn carriage . . . or a pedicab," "witnessing or participating in any amateur production or activity," "witnessing or participating in any amusement sponsored or conducted by and the proceeds of which . . .

> (1) any exhibition, performance, presentation or show for entertainment purposes, including, but not limited to, any theatrical, dramatic, musical or spectacular performance, promotional show, motion picture show, flower, poultry or animal show, animal act, circus, rodeo, athletic contest, sport, game or similar exhibition such as boxing, wrestling, skating, dancing, swimming, racing, or riding on animals or vehicles, baseball, basketball, softball, football, tennis, golf, hockey, track and field games, bowling or billiard or pool games; (2) any entertainment or recreational activity offered for public participation or on a membership or other basis including, but not limited to, carnivals, amusement park rides and games, bowling, billiards and pool games, dancing, tennis, racquetball, swimming, weightlifting, bodybuilding or similar activities; or (3) any paid television programming, whether transmitted by wire, cable, fiber optics, laser, microwave, radio, satellite or similar means.[75]

The amusement tax also provides that it is the responsibility of every reseller, owner, manager or operator of an amusement or a place of amusement to collect the tax from each patron or buyer and to remit the tax to the Department of Finance.[76]

2. Amusement Tax Ruling No. 5

On June 9, 2015, the City of Chicago's Finance Department issued a ruling, effective July 1, 2015, stating the city's 9% amusement tax includes "the privilege to witness, view or participate in amusements that are delivered electronically,"[77] and patrons will usually obtain these amusements on a "television, radio, computer, tablet, cell phone or other device belonging to the customer."[78] Instead of having the City

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inure exclusively to the benefit of" various charitable causes, societies, organizations, military services, organizations that benefit police and fire departments, and symphony orchestras, opera performances or artistic presentations. *Id.* § 4-156-020(B).

75. *Id.* § 4-156-010.

76. *Id.* § 4-156-030(A) ("It shall be the joint and several duty of every owner, manager or operator of an amusement or of a place where an amusement is being held, and of every reseller to secure from each patron or buyer the tax imposed by Section 4-156-020 of this article and to remit the tax to the department of finance not later than the 15th day of each calendar month for all admission fees or other charges received during the immediately preceding calendar month.").

77. City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5, ¶ 8 (June 9, 2015).

78. *Id.*

Council vote on whether to create a new tax on streaming services, Chicago's Department of Finance clarified the preexisting amusement tax includes Internet access.[79] This ruling mandates that:

> [(1)] charges paid for the privilege of watching electronically delivered television shows, movies or videos are subject to the amusement tax, if the shows, movies or videos are delivered to a patron (i.e., customer) in the City . . .;
>
> [(2)] charges paid for the privilege of listening to electronically delivered music are subject to the amusement tax, if the music is delivered to a customer in the City; and
>
> [(3)] charges paid for the privilege of participating in games, on-line or otherwise, are subject to the amusement tax if the games are delivered to a customer in the City.[80]

The ruling further specifies the tax on electronically delivered amusements "does not apply to sales of shows, movies, videos, music or games (normally accomplished by a 'permanent' download). [The tax] applies only to rentals (normally accomplished by streaming or 'temporary' download)," and the tax may be based on "subscription fees, per-event fees or otherwise."[81] The amusement tax applies to customers who reside in Chicago.[82] Moreover, the tax only applies to amusements "that take[] place within Chicago."[83] This ruling means that only applicable amusements, accessed in Chicago by residents of Chicago, will be taxed.[84] Thus, residents in other areas of Illinois and residents

79. Gary Shapiro, *Commentary: No One's Smiling About Chicago's 'Amusement Tax'*, CHICAGO TRIBUNE (Aug. 24, 2015, 4:52 PM), http://www.chicagotribune.com/news/opinion/commentary/ct-amusement-tax-streaming-netflix-hulu-perspec-0825-20150824-story.html.

80. City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5 ¶¶ 8(a)–(c) (June 9, 2015).

81. *Id.* ¶ 10. The City of Chicago is likely trying to extend the amusement tax only to temporary downloads, and not permanent downloads, because leasing tangible personal property is subject to tax, whereas service transactions are not. JENSEN, *supra* note 10, at 6.

82. City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5, ¶ 13 (June 9, 2015) ("In general, this means that the amusement tax will apply to customers whose residential street address or primary business street address is in Chicago, as reflected by their credit card billing address, zip code or other reliable information."). Thus, in summary, the customer must both live in Chicago and use the rented Internet amusement in Chicago. *Id.* ¶¶ 13, 14.

83. *Id.* ¶ 14 (emphasis added).

84. *See id.* ¶¶ 13, 14.

in other states will not be taxed for using the same streaming services unless that city or state has an Internet tax that was grandfathered by ITFA.

Additionally, the ruling sheds light on what happens when a charge includes both taxable and non-taxable elements, otherwise known as "bundled" elements.[85] The ruling indicates the same rules apply as in the Personal Property Lease Transaction Tax Ruling No. 3.[86] Personal Property Lease Transaction Tax Ruling No. 3 provides in pertinent part that "[i]f the lessor fails to separate the lease or rental portion of the price from the non-lease or non-rental portion, the entire price charged shall be deemed taxable, unless it is clearly proven that at least 50% of the price is not for the use of any personal property."[87] Thus, in summary, "if a bundled charge is primarily for the privilege to enter, to witness, to view or to participate in an amusement, then the entire charge is taxable."[88] "[I]n November 2015, the City Council amended the Amusement Tax Ordinance to endorse the use of the Mobile Sourcing Act . . . confirm[ing that] the Amusement Tax applies to videos, music and games streamed over the internet."[89]

3. Comptroller's Authority

The Comptroller heads Chicago's department of finance and "manage[s] and control[s] . . . all matters and things pertaining thereto."[90] The Comptroller supervises the city's officers in regard to the "receipt, collection or disbursement of the city revenues and all funds required to be in the custody of the city treasurer."[91] Among other authorities enumerated in the municipal code, the Comptroller has the power "to make and enforce such reasonable rules and regulations as may be necessary to effectively administer any of the powers granted the Comptroller in this code."[92]

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85. *Id.* ¶ 12.

86. *Id.*; City of Chicago, Dept. of Revenue, Personal Property Lease Transaction Tax Ruling No. 3 (June 1, 2004), http://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/TransTaxRuling3.pdf.

87. *Id.* § 5.

88. City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5, ¶ 12 (July 1, 2015).

89. Opinion and Order on Motion to Dismiss the Amended Complaint at 3, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. July 21, 2016) [hereinafter Opinion and Order].

90. CHI., ILL., MUN. CODE § 2-32-020 (1990).

91. *Id.* § 2-32-030.

92. *Id.* § 2-32-096.

B. Pasadena's Utility Tax

Similar to Chicago's Amusement tax, Pasadena's Code of Ordinances included a pre-existing utility tax, passed in 2008 by vote of the city's residents.[93] Pasadena's Code of Ordinances states:

> [t]here is imposed a tax upon every person using video services in the city from a video service supplier. The tax imposed by this section shall be at the rate established under Section 4.56.180(A). The tax shall apply to all charges made for such video services, and shall be collected from the service user by the video service supplier, or its billing agent.[94]

The rate of Pasadena's video tax is 9.4%.[95] Additionally, Pasadena's Code of Ordinances defines a "video service supplier" as:

> any person, company, or service which provides one or more channels of video programming, including any communications that are ancillary, necessary or common to the use and enjoyment of the video programming, to or from an address in the city, including to or from a business, home, condominium, or apartment, where some fee is paid, whether directly or included in dues or rental charges for that service, whether or not public rights-of-way are utilized in the delivery of the video programming or communications. A 'video service supplier' includes, but is not limited to, multichannel video programming distributors . . . , open video systems (OVS) suppliers, suppliers of cable television, master antenna television, satellite master antenna television, multichannel multipoint distribution services (MMDS), direct broadcast satellite (to the extent allowed by federal law), and other suppliers of video programming or communications (including two-way communications), whatever their technology.[96]

In relevant part, the Ordinance also provides that:

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93. James F. Peltz, *Pasadena and Other California Cities Weigh a 'Netflix Tax' for Video Subscribers*, L.A. TIMES (Oct. 3, 2016, 3:00 AM), http://www.latimes.com/business/la-fi-agenda-netflix-tax-20161003-snap-story.html.

94. PASADENA, CA., CODE OF ORDINANCES, Ch. 4.56.070(A).

95. *City of Pasadena: Utilities Subject to Tax*, UUTINFO.ORG, http://www.uutinfo.org/uutinfo_city_info/pasadena/uutinfo_pasadena.htm (last visited June 1, 2017).

96. PASADENA, CAL., CODE OF ORDINANCES § 4.56.020(Q) (2016) (emphasis added).

As used in this section, the term "charges" shall apply to all services, components and items that are:

1. Necessary or common to the receipt, use or enjoyment of video service; or,

2. Currently, or historically have been, included in a single or bundled rate for video service by a local video service supplier to a class of retail customers. The term "charges" shall include, but is not limited to, the following:

a. Franchise fees and access fees (PEG), whether designated on the customer's bill or not;

b. Initial installation of equipment necessary for provision and receipt of video services;

c. Late fees, collection fees, bad debt recoveries, and return check fees;

d. Activation fees, reactivation fees, and reconnection fees;

e. All programming services (e.g., basic services, premium services, audio services, video games, pay-per-view services, and electronic program guide services);

f. Equipment leases (e.g., converters, remote devices);

g. Service calls, service protection plans, name changes, changes of services, and special services (e.g., no promotional mail); and

h. The leasing of channel access.[97]

This revision to Pasadena's utility tax became effective on January 1, 2017.[98]

97. *Id.* § 4.56.070(B).
98. *See* Henry, *supra* note 17.

V. *LABELL V. CITY OF CHICAGO*: THE ARGUMENTS MADE BY THE USERS OF ONLINE STREAMING SERVICES IN CHICAGO IN RESPONSE TO THE EXPANSION OF CHICAGO'S NINE PERCENT AMUSEMENT TAX

A. Background

After Chicago's Finance Department ruled that Chicago's amusement tax now includes electronically delivered amusements, the Liberty Justice Center, on behalf of six citizens of Chicago who are users of streaming services such as Netflix, X-Box Live and Amazon Prime, filed a lawsuit challenging the Finance Department's authority to issue this ruling and alleging the ruling violates ITFA.[99] The Complaint was filed in the Circuit Court of Cook County, Illinois on September 9, 2015 by residents of Cook County, Illinois.[100] The users sued the City of Chicago, as well as Dan Widawsky, the Comptroller for the City of Chicago and head of Chicago's Finance Department.[101] Each proceeding will be laid out. However, only the counts applying to other states will be analyzed.

B. The Original Complaint

The original Complaint, filed on September 9, 2015, includes four counts.[102] The first three counts deal with the Comptroller's Authority.[103] The fourth count discusses the Amusement Tax's violation of ITFA.[104]

1. Counts I, II and III: "The City of Chicago Comptroller has exceeded his authority by adopting Amusement Tax Ruling [No.] 5 and by extending the City's Amusement Tax to Internet-based streaming."[105]

The plaintiffs argue that although the "Chicago Municipal Code authorize[d] the Comptroller to 'adopt, promulgate and enforce rules and regulations pertaining to the interpretation, administration and

99. *Labell*, LJC, *supra* note 19; *see also* Complaint for Declaratory and Injunctive Relief ¶ 1, Labell v. City of Chicago (Ill. Cir. Ct. Sept. 9, 2015) (No. 2015-CH-13399) [hereinafter Complaint].
100. *See* Complaint, *supra* note 99, ¶ 4.
101. *See id.* ¶ 12.
102. *Id.* ¶¶ 35–86.
103. *Id.* ¶¶ 35–74.
104. *Id.* ¶¶ 75–86.
105. *Id.* ¶¶ 35–74 (see titles of Count I, Count II and Count III).

enforcement' of Chicago's Amusement Tax,"[106] the Municipal Code did not give the Comptroller the authority "to impose new taxes that the City Council has not authorized through a city ordinance."[107]

In count I of the original Complaint, the plaintiffs argue the Comptroller exceeded his authority because taxes on streaming services did not fall into the definition of amusements pursuant to Chicago's amusement tax.[108] Additionally, the plaintiffs argue taxing services such as Amazon Prime is a tax on membership fees, which covers both amusement and non-amusement activities.[109]

In the second count, the plaintiffs assert audio streaming services do not fall within the definition of "amusement" as defined in Chicago's amusement tax, and the Comptroller exceeded his authority by imposing a tax on audio streaming services.[110] Additionally, the plaintiffs contend Amazon Prime provided more services than just movies and music, such as shipping, discounted merchandise, photo storage on the cloud, and e-books.[111] Thus, the plaintiffs argue the tax imposed on Amazon Prime is invalid, as Amazon Prime is not an "amusement" as defined in Chicago's amusement tax.[112]

In the third count, the plaintiffs contend gaming services streamed from the Internet do not fall into the definition of Chicago's amusement tax.[113] Additionally, the plaintiffs assert these streaming services may be used by residents of Chicago both inside and outside of the city.[114] The plaintiffs also argue the amusement tax on Xbox Gold imposes a tax on "both amusement and nonamusement activities," as Xbox Gold members have access to chat, matchmaking, voice communication, recording, broadcasting, free games, storing files via cloud storage, and more.[115] Thus, the plaintiffs contend a tax on Xbox Gold is not an amusement pursuant to Chicago's amusement tax.[116] However, these arguments will not be analyzed, as they are not at issue for the purposes of this Note.

106. *Id.* ¶ 36.
107. *Id.* ¶ 37.
108. *Id.* ¶¶ 38, 40–42.
109. *Id.* ¶ 43.
110. *Id.* ¶¶ 52, 54.
111. *Id.* ¶ 55.
112. *Id.* ¶ 56.
113. *Id.* ¶ 64.
114. *Id.* ¶ 65.
115. *Id.* ¶ 67.
116. *Id.* ¶ 68.

2. "Count IV[:] Amusement Tax Ruling [No.] 5's tax on streaming services violates the Internet Tax Freedom Act, 47 U.S.C. § 151 note (2015)."[117]

Finally, in the fourth count, the plaintiffs argue ITFA "provides that no State or political subdivision of a State may impose multiple or discriminatory taxes on electronic commerce."[118] The plaintiffs contend the amusement tax unlawfully imposes a discriminatory tax on electronic commerce in two specific ways. First, the plaintiffs assert that since the tax only "applies to Netflix's video streaming service, but . . . not . . . to [its] video-by-mail service," it is discriminatory and, thus, unlawful.[119] Second, the plaintiffs argue that since "theatrical, musical, and cultural performances" streamed electronically are to be taxed at a higher rate than if the performances were viewed in person, it is discriminatory and, thus, unlawful.[120]

C. The First Amended Complaint

On December 17, 2015, the plaintiffs filed their First Amended Complaint.[121] The First Amended Complaint adds counts V and VI.[122]

1. "Count V: Amusement Tax Ruling [No.] 5's tax on streaming services violates the Uniformity Clause of the Illinois Constitution, Article IX, Section 2."[123]

The Uniformity Clause states that "[i]n any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable."[124] The Amended Complaint further contends that

> [i]n order to comply with the Uniformity Clause, a tax must meet two requirements: (1) it must be based on a "real and

117. *See id.* ¶¶ 75–86 (see Title of Count IV).
118. *Id.* ¶ 76.
119. *Id.* ¶ 80.
120. *Id.* ¶ 81.
121. First Amended Complaint for Declaratory and Injunctive Relief, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. Dec. 17, 2015) [hereinafter First Amended Complaint].
122. *See id.* ¶¶ 87–104.
123. *See id.* ¶¶ 87–96.
124. ILL. CONST. art IX, § 2.

substantial" difference between those subject to the tax and those that are not; and (2) it must "bear some reasonable relationship to the object of the legislation or to public policy."[125]

The Amended Complaint states there is no real and substantial difference, as the amusement tax "provides a reduced rate of five percent for in-person live theatrical, live musical or other live cultural performances that take place in any auditorium, theater or other space in the city"[126] but "electronically delivered audio or video of the same performance is taxed at nine percent."[127] For purposes of this Note, the Uniformity Clause will not be analyzed.

2. "Count VI[:] Amusement Tax Ruling [No.] 5's tax on streaming services violates the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3."[128]

The First Amended Complaint also adds count VI, stating Amusement Tax Ruling No. 5 violates the Commerce Clause of the United States Constitution.[129] The Commerce Clause, found in Article I, Section 8, clause 3 of the U.S. Constitution declares "Congress shall have Power . . . [t]o regulate commerce with foreign nations, and among the several States."[130] The Commerce Clause authorizes the Federal government to regulate interstate commerce.[131] The Commerce Clause "permits Congress to legislate when it perceives that the national welfare is not furthered by the independent actions of the States" and it is also "well-established . . . that the Clause itself is 'a limitation upon state power even without congressional implementation.'"[132]

The Complaint suggests "[a] local tax satisfies the Commerce Clause only if it '(1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State.'"[133] The Complaint argues "the Ruling[] does not

125. First Amended Complaint, *supra* note 121, ¶ 89 (quoting Arangold Corp. v. Zehnder, 787 N.E.2d 786, 793 (Ill. 2003)).
126. *Id.* ¶ 92.
127. *Id.* ¶ 93.
128. *See id.* ¶¶ 97–104 (see Title of Count VI).
129. *Id.* ¶ 100.
130. U.S. CONST. art. I, § 8, cl. 3.
131. *See id.*
132. Kassel v. Consol. Freightways Corp., 450 U.S. 662, 669 (1981) (quoting Hunt v. Wash. State Apple Advert. Comm'n, 432 U.S. 333, 350 (1977)).
133. First Amended Complaint, *supra* note 121, ¶ 99 (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 311 (1992)).

satisfy the first requirement of the Commerce Clause because the activities that it taxes—Internet-based streaming of video, audio, and gaming—do not have a substantial nexus with the taxing jurisdiction, Chicago, since the activities do not take place in Chicago, but on the Internet."[134] The Amended Complaint contends the second requirement is not satisfied "because the tax is not limited to the portion of value that is fairly attributable to economic activity within the taxing jurisdiction. The City cannot tax economic value exclusively attributable to out-of-state activities—here the provision of Internet-based streaming services by out-of-state companies."[135] Additionally, the Amended Complaint alleges the third requirement is not met because "[t]he Amusement tax imposes a higher tax rate on theatrical, musical, and cultural performances that are delivered through an online streaming service provided by out-of-state providers than it imposes on those same performances if they are consumed exclusively in the City of Chicago."[136] Lastly, the Amended Complaint indicates the fourth requirement is not satisfied because

> Internet-based streaming video, audio, and gaming services from providers that have no connection to the City of Chicago, except that some of their customers have billing addresses in Chicago, are in no way related to any services provided by the City. Sporting events and concerts and other amusements that take place in the City of Chicago and cable television, are given "protection, opportunities and benefits" of the City of Chicago and state of Illinois, whereas out-of-state providers of Internet-based streaming services receive no such protection, opportunities and benefits.[137]

D. City of Chicago's Motion to Dismiss

On January 19, 2016, the City of Chicago filed a Motion to Dismiss the Amended Complaint.[138] On July 21, 2016, Judge Carl Anthony Walker "granted the city's motion to dismiss the first three counts of the lawsuit, which challenged its Comptroller's authority to impose a new

134. *Id.* ¶ 100.
135. *Id.* ¶ 101.
136. *Id.* ¶ 102.
137. *Id.* ¶ 103 (quoting Asarco, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982)).
138. Opinion and Order, *supra* note 89, at 2.

tax."[139] In sum, the Motion alleged counts I through III should be dismissed because the Comptroller did not "create a new tax or otherwise expand the scope of the [o]rdinance."[140] The Motion argued the standard the court uses to determine the scope of the Comptroller's authority is that there are "no circumstances" in which the law would be valid.[141] Thus, in his opinion, Judge Walker ruled that since "the City Council amended the Amusement Tax to specifically include video streaming, audio streaming and on-line games delivered electronically to mobile devices, whether the Comptroller exceeded his authority by adopting the Ruling is moot," and dismissed counts I, II, and III.[142]

Judge Walker, however, denied the Motion to Dismiss counts IV, V and VI of the Complaint.[143] In these counts, the City's Motion to Dismiss contended (1) "[t]he Amusement Tax does not discriminate against electronic commerce and therefore does not violate the Internet Tax Freedom Act,"[144] (2) "[t]he Ruling does not violate the Uniformity Clause because having a separate classification for live cultural performances is a reasonable way of advancing the City's objective of fostering a healthy and vibrant artistic atmosphere in the City,"[145] and (3) "[t]he Ruling does not violate the Commerce Clause."[146] Judge Walker held "that the residents' complaint 'alleges sufficient facts to state a cause of action' for the other three counts—violation of the Internet Tax Freedom Act, or ITFA, as well as violations of the Illinois Constitution's Uniform Clause and the U.S. Constitution's Commerce Clause."'[147]

E. Second Amended Complaint

A Second Amended Complaint was filed on October 12, 2016,[148] after Judge Walker's Order was issued. In relevant part, the Second Amended Complaint adds count VII.[149]

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139. Lisa Klein, *Chicago Must Defend 9% Tax on Streaming Services*, COURTHOUSE NEWS SERVS. (July 21, 2016) http://www.courthousenews.com/chicago-must-defend-9-tax-on-streaming-services.

140. Chicago's Memorandum in Support of Motion to Dismiss Amended Complaint at 22, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. Jan. 19, 2016) [hereinafter Motion to Dismiss Amended Complaint].

141. *Id.* at 2.

142. Opinion and Order, *supra* note 89, at 3.

143. *See id.* at 3–4.

144. Motion to Dismiss Amended Complaint, *supra* note 140, at 13.

145. *Id.* at 16.

146. *Id.* at 19.

147. Klein, *supra* note 139; *see also* Opinion and Order, *supra* note 89, at 4.

148. Plaintiff's Motion for Leave to File Second Amended Complaint, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. July 21, 2016).

1. "Count VII: Amusement Tax Ruling [No.] 5's tax on streaming services exceeds the City's authority under the Illinois Constitution."[150]

Count VII of the Complaint contends "[u]nder Illinois law, all home rule ordinances must fall within the scope of Article VII, Section 6(a) of the Illinois Constitution, which states that 'a home rule unit may exercise any power and perform any function pertaining to its government and affairs.'"[151] The Complaint states "[t]he Illinois Constitution prohibits home rule units from taxing business transactions outside of their respective jurisdictions because such taxation constitutes an unauthorized extraterritorial exercise of power."[152] Thus, the Complaint alleges Amusement Tax Ruling No.5 "subjects customers with Chicago billing addresses to tax on the charges paid for video streaming services, listening to electronically delivered music and participating in games online when those customers are located outside of the City at the time they incur the charges," and thus, the Ruling has "an extraterritorial effect."[153] This argument will not be analyzed for the purposes of this Note.

VI. CHICAGO'S EXPANSION OF THE NINE PERCENT AMUSEMENT TAX GOES TOO FAR: THE COURT IN *LABELL V. CITY OF CHICAGO* SHOULD HOLD THE TAX INVALID

This Note focuses on the arguments in *Labell v. City of Chicago*,[154] such as ITFA and the Commerce Clause of the U.S. Constitution, applicable to other states with similar taxes. Therefore, this Note limits its analysis to counts IV and VI of the Complaint in *Labell v. City of Chicago*, and omits analysis of counts arguing only Illinois specific law (counts I, II, III, V and VII).

149. *Id.* at 2.

150. Second Amended Complaint for Declaratory and Injunctive Relief at 25, Labell v. City of Chicago, No. 2015-CH-13399 (Ill. Cir. Ct. July 21, 2016) [hereinafter Second Amended Complaint].

151. *Id.*

152. *Id.* (citing Seigles, Inc. v. City of St. Charles, 849 N.E.2d 456 (Ill. App. Ct. 2006)).

153. *Id.* at 25–26.

154. No. 2015-CH-13399 (Ill. Cir. Ct. July 21, 2016).

A. Analysis of "Count IV: Amusement Tax Ruling [No.] 5's tax on streaming services violates the Internet Tax Freedom Act, 47 U.S.C. § 151 (2015)."[155]

Importantly, the suit alleges "Amusement Tax Ruling [No.] 5's tax on streaming services violates the Internet Tax Freedom Act."[156] The Complaint contends that even if City Council voted on Amusement Tax No. 5, and the tax was passed, the tax is still invalid because it is discriminatory and violates ITFA.[157]

First, it is essential to determine whether Chicago's amusement tax was created and enforced before ITFA in order to ultimately conclude whether Chicago's amusement tax could be protected by ITFA's grandfather clause until June 30, 2020. The current Municipal Code of Chicago was published in 1990.[158] The Code specifies it is a "new and original comprehensive ordinance, completely superseding the Municipal Code of Chicago adopted August 30, 1939, and subsequent code amendments adopted prior to February 28, 1990."[159] This Code includes Chicago's present amusement tax, and, thus, the original amusement tax was adopted in 1990.[160] As previously mentioned, ITFA was enacted in 1998.[161] Therefore, the amusement tax, as originally stated in the Municipal Code of Chicago, predates ITFA.

Next, it is pertinent to analyze if Chicago's extended amusement tax violates ITFA by determining whether Amusement Tax Ruling No. 5 is protected by ITFA's grandfather clause until June 30, 2020. ITFA states the tax must have been "generally imposed and actually enforced prior to October 1, 1998."[162] Although Chicago's original amusement tax was imposed and enforced before the enactment of ITFA, the amusement tax on streaming services was not. This is evident because Chicago's Finance Department issued Amusement Tax Ruling No. 5 on June 9, 2015, stating Chicago's 9% amusement tax includes "[t]he privilege to witness, view or participate in amusements that are delivered electronically."[163] Amusement Tax Ruling No. 5 did not

155. Complaint, *supra* note 99, at 14.
156. *Id.*
157. *Id.* ¶¶ 75–86.
158. *See* CHI., ILL., MUN. CODE (1990).
159. *Id.* § 1-4-010.
160. *Id.* § 4-156-020.
161. *See* ITFA, 47 U.S.C. 151, §§ 1100–1206 (1998).
162. *Id.* § 1101(a)(1).
163. City of Chicago, Dept. of Finance, Amusement Tax Ruling No. 5, ¶ 8 (July 1, 2015), https://www.cityofchicago.org/content/dam/city/depts/rev/supp_info/TaxRulingsandRegulations/AmusementTaxRuling_5_06_09_2015.pdf.

become effective until July 1, 2015.[164] Thus, it is apparent a tax on Internet usage was not "generally imposed and actually enforced" prior to ITFA because the amusement tax did not include Internet usage until July 1, 2015.[165] Ultimately, Chicago's amusement tax is not protected by ITFA's grandfather clause and therefore violates ITFA.

B. Analysis of "Count VI: Amusement Tax Ruling [No.] 5's tax on streaming services violates the Commerce Clause of the United States Constitution, Article I, Section 8, Clause 3."[166]

The Commerce Clause, found in Article I, Section 8, clause 3 of the United States Constitution declares, "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States."[167] The Commerce Clause gives the federal government the positive authority to regulate interstate commerce.[168] "The [Commerce] Clause permits Congress to legislate when it perceives that the national welfare is not furthered by the independent actions of the States. It is now well established, also, that the Clause itself is 'a limitation upon state power even without congressional implementation.'"[169]

Additionally, Article I, Section 8, clause 3 of the United States Constitution implies a negative power called the "dormant Commerce Clause."[170] The dormant Commerce Clause prevents states from imposing a tax in any manner "that would materially burden or discriminate against interstate commerce."[171] This doctrine is

164. *Id.* at 1.

165. ITFA § 1101(a)(1).

166. Second Amended Complaint, *supra* note 150, at 22.

167. U.S. CONST. art. I, § 8, cl. 3.

168. *See id.*

169. Kassel v. Consol. Freightways Corp., 450 U.S. 662, 669 (1981) (plurality opinion) (quoting Hunt v. Wash. State Apple Advert. Comm'n, 432 U.S. 333, 350 (1977)).

170. Renee L. Giachino, *Commerce Clause in Cyberspace*, CTR. FOR INDIVIDUAL FREEDOM (2001), http://www.cfif.org/htdocs/legal_issues/legal_activities/policy_papers/commerceclause.html.

171. *Id.*; *see also Kassel*, 450 U.S. at 669 (plurality opinion). *Kassel* is a prominent dormant Commerce Clause case, illustrating the doctrine and highlighting the standard a state must meet in order to legislate in a way that burdens interstate commerce. *Id.* at 669–71. In *Kassel*, the state of Iowa prohibited the use of sixty-five foot double trucks within the state, but Iowa provided for exceptions for cities that bordered Iowa, farm vehicles, and the same trucks that were manufactured in Iowa, and mobile homes moved within the state. *Id.* at 665–66. Iowa argued that the use of the sixty-five foot double trucks was unsafe, but the Court was not persuaded by this argument, as Iowa could not provide any persuasive evidence. *Id.* at 671–74. Although this statute seemed to be neutral on its face, interstate commerce was affected because sixty-five foot double trucks that did not fall into the exceptions had to either adjust their routes to avoid Iowa, or detach their trailers and deliver them separately through Iowa. *Id.* at 674.

enforceable under the Supremacy Clause of the Constitution, which "provides that federal law is supreme over state law, [and that] states are restricted from enacting laws contrary to federal law."[172]

States violate the dormant Commerce Clause when the state legislates in a way that favors in-state economic interests over out-of-state interests, because the state action discriminates against other states in a way that affects interstate commerce.[173] The primary purpose of the dormant Commerce Clause is to protect out-of-staters from economic discrimination and balkanization of state markets.[174] The dormant Commerce Clause doctrine provides "because Congress has the power to regulate and promote trade among states, state government cannot promulgate legislation or regulations that frustrate or inhibit trade between states, even in the absence of Congressional legislation."[175] If a state law burdens interstate commerce, then it violates the dormant Commerce Clause, even if there is no Federal legislation on the subject.[176]

The United States Supreme Court has created various tests to conclude whether a state's legislation violates the Commerce Clause.[177] When state legislation facially discriminates against anyone who does not live in that state, the law is subject to "the strictest scrutiny of any purported legitimate [social] purpose and of the absence of nondiscriminatory alternatives."[178] Since this is the type of legislation

172. Shelley Ross Saxer, *Eminent Domain, Municipalization, and the Dormant Commerce Clause*, 38 U.C. DAVIS L. REV. 1505, 1554–55 (2005); *see also* U.S. CONST. art. VI, cl. 2 ("This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

173. Saxer, *supra* note 172, at 1521.

174. Jack L. Goldsmith & Alan O. Sykes, Essay, *The Internet and the Dormant Commerce Clause*, 110 YALE L. J. 785, 788 (2001).

175. Michael W. Loudenslager, *Allowing Another Policeman on the Information Superhighway: State Interests and Federalism on the Internet in the Face of the Dormant Commerce Clause*, 17 BYU J. PUB. L. 191, 193 (2003).

176. Bruce P. Keller, *The Game's the Same: Why Gambling in Cyberspace Violates Federal Law*, 108 YALE L.J. 1569, 1593–94 (1999).

177. Giachino, *supra* note 170.

178. Goldsmith & Sykes, *supra* note 174, at 788. A second test is used when state legislation is "nondiscriminatory on its face but nonetheless impinges on interstate commerce." *Id.* at 788. Thus, if the law is "neutral state legislation that burdens interstate commerce," then the court will apply a balancing test as follows: "[w]here the statute regulates evenhandedly to effectuate a legitimate [state] . . . interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 788–89. Additionally, state legislation that "regulate[s] extraterritorially," and some state laws

under scrutiny in *Labell v. City of Chicago*, it will be the only test discussed.[179]

Although no cases directly address the issue of taxing Internet usage, there are a few cases about similar Internet taxes, such as sales tax. For example, in *Overstock.com, Inc. v. New York State Department of Taxation & Finance*, plaintiffs argued the Internet tax was facially unconstitutional and violated the Commerce Clause, "by subjecting online retailers, without a physical presence in the state, to New York sales and compensating use taxes."[180] *Overstock.com* presents a relevant test to be applied in *Labell v. City of Chicago* and other similar lawsuits: a state tax impacting interstate commerce "will be upheld '[1] when the tax is applied to an activity with a substantial nexus with the taxing State,[181] [2] is fairly apportioned, [3] does not discriminate

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that result in "inconsistent regulatory burdens" are invalid due to the dormant Commerce Clause. *Id.* However, these principles are still unclear and are applied inconsistently by the courts. *Id.* The test for state laws that "regulate extraterritorially" is "whether the practical effect of the regulation is to control conduct beyond the boundaries of the state." *Id.* Extraterritorial regulation is prohibited by the Full Faith and Credit clause and Due Process clause of the Constitution, unless the topic of legislation "creates a 'significant contact' or 'significant aggregation of contacts' with[in] the state." *Id.* Moreover, dicta by the court has alluded the extraterritoriality principle prohibits "the application of a state statute to commerce that takes place wholly outside of the state's borders, whether or not the commerce has effect within the state." *Id.* The test for state laws that result in "inconsistent regulatory burdens" are regulations that "adversely affect interstate commerce by subjecting activities to inconsistent regulations." *Id.* at 789–90.

179. *See, e.g.*, Complaint, *supra* note 99, at 21–24.

180. Overstock.com, Inc. v. New York State Dept. of Taxation & Fin., 987 N.E.2d 621, 621 (N.Y. 2013). Although the Court in *Overstock.com* decided this case under existing physical presence inquiry, the Court noted that due to the companies' increasing "virtual projection via the Internet" the Supreme Court will likely have to adjudicate if the physical presence test is still a valid inquiry. *Id.* at 625. The Court also noted:

> [F]acial constitutional challenges are disfavored. "Legislative enactments enjoy a strong presumption of constitutionality . . . [and] parties challenging a duly enacted statute face the initial burden of demonstrating the statute's invalidity 'beyond a reasonable doubt.' Moreover, courts must avoid, if possible, interpreting a presumptively valid statute in a way that will needlessly render it unconstitutional."

Id. at 629 (quoting LaValle v. Hayden, 98 N.E.2d 490, 494 (2002)).

181. A substantial nexus cannot be found where an "out-of-state mail-order business . . . d[oes] not have offices, property or sales representatives" in the state. *Overstock.com*, 987 N.E.2d at 625 (citing Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill., 386 U.S. 753, 758 (1967)). However, the Court later changed the test so that a nexus "need not be substantial. Rather, it must be demonstrably more than a 'slight[] presence.'" Orvis Co. v. Tax Appeals Tribunal of N.Y., 654 N.E.2d 954, 960–61 (1995) (quoting Nat'l Geographic Soc'y v. California Bd. Of Equalization, 430 U.S. 551, 556 (1977)). *Overstock.com* holds that "[a]ctive, in-state solicitation that produces a significant amount of revenue qualifies as 'demonstrably more than a 'slight[] presence' under *Orvis*.'" *Overstock.com*, 987 N.E.2d at 626 (quoting *Orvis*, 654 N.E.2d at 960–61).

against interstate commerce, and [4] is fairly related to the services provided by the State.'"[182]

Overstock.com is also significant because the court noted there are many similarities between mail-order businesses and online retailers, which is a main concern in *Labell v. City of Chicago*.[183] Both mail-order businesses and online retailers generally operate without having a "physical presence" in most states.[184] For example, a "physical presence is not typically associated with the Internet in that many websites are designed to reach a national or even a global audience from a single server whose location is of minimal import."[185] Thus, where the owner of the website resides weighs heavily in determining the "physical presence" of that website.[186]

Additionally, courts have already ruled that almost any state legislation involving the Internet will violate the dormant Commerce Clause.[187] For example, the court in *American Libraries Ass'n v. Pataki* recognized the issue of individual states attempting to tax the Internet.[188] The court in *American Libraries Ass'n* noted "the Internet is one of those areas of commerce that must be marked off as a national preserve to protect users from inconsistent legislation that, taken to its most extreme, could paralyze development of the Internet altogether."[189] Therefore, the dormant Commerce Clause should prevent states from legislating on taxing Internet usage, leaving the topic to the federal government.

Moreover, to generate additional revenue, states have taxed online gambling, providing further insight on Internet taxation in the context of the dormant Commerce Clause.[190] Gambling, similar to online

182. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). This test is also cited in *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992), as stated in *Labell*.

183. *See Overstock.com*, 957 N.E.2d at 625–26.

184. *Id.*

185. *Id.*

186. *Id.* The Court recognizes the "physical presence" of the website owner is important because many websites are focused on targeting local audiences. *Id.* However, *Labell v. City of Chicago* deals with more nationally known online services, such as Netflix, Spotify, and Xbox Live. *Labell*, LJC, *supra* note 19.

187. *See*, Loudenslager, *supra* note 175, at 193–94; Am. Libraries Ass'n v. Pataki, 969 F. Supp. 160, 181 (S.D.N.Y. 1997).

188. *See American Libraries Ass'n*, 969 F. Supp. at 169; Goldsmith & Sykes, *supra* note 174, at 786-87.

189. *American Libraries Ass'n*, 969 F. Supp. at 169.

190. *See* Keller, *supra* note 176, at 1577. Additionally, some online gambling sites are run in foreign nations, and escape United States regulations. *Id.* at 1570–71.

streaming and cloud services, has rapidly expanded.[191] Gambling laws have primarily been left to the states.[192] However, the federal government recognized that allowing the states to legislate taxation on gambling creates a large disparity of laws throughout the country.[193] Because the same underlying problem is apparent in taxing Internet usage, the federal government should decide whether to regulate Internet usage taxation and whether to allow taxing streaming services, as opposed to leaving this power to the states.

Chicago's amusement tax and Pasadena's utility tax are facially discriminatory because they explicitly discriminate between those who live in Illinois and California and have to pay the amusement tax on streaming services and those who do not live in these states and do not have to pay a tax on the same services. Chicago's amusement tax and Pasadena's utility tax are, therefore, subject to "the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives."[194]

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191. *Id.* at 1577. In 1988, just two states, Nevada and New Jersey, allowed gambling. *Id.* However, almost every state (with the exception of Utah and Hawaii) has legalized some type of gambling. *Id.*

192. *Id.*

193. *Id.*

194. Goldsmith & Sykes, *supra* note 174, at 788 (quoting Hughes v. Oklahoma, 441 U.S. 322, 337 (1979)). A second test applies when state legislation is "nondiscriminatory on its face but nonetheless impinges on interstate commerce." *Id.* at 788. Thus, if the law is "neutral state legislation that burdens interstate commerce," then the court will apply a balancing test as follows: "[w]here the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 788–89 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)). Additionally, state legislation that "regulates extraterritorially," and some state laws that result in "inconsistent regulatory burdens" are invalid due to the dormant Commerce Clause. *Id.* at 789–90. However, these principles are still unclear and are applied inconsistently by the courts. *Id.* The test for state laws that "regulate extraterritorially" is "whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Id.* at 789 (quoting Healy v. Beer Inst., 491 U.S. 324, 336 (1989)). Extraterritorial regulation is prohibited by the Full Faith and Credit clause and the Due Process clause of the Constitution, unless the topic of legislation "creates a 'significant contact' or 'significant aggregation of contacts' with the state." *Id.* at 789 (quoting Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 818 (1985)). Moreover, dicta by the court has alluded that the extraterritoriality principle prohibits "the application of a state statute to commerce that takes place wholly outside of the State's borders, *whether or not the commerce has effects within the State.*" *Id.* at 789–90 (emphasis in original) (quoting Healy v. Beer Inst., Inc., 491 U.S. 324, 336 (1989)). The test for state laws that result in "inconsistent regulatory burdens" are regulations that "adversely affect interstate commerce by subjecting activities to inconsistent regulations." *Id.* at 789–90 (quoting CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 88 (1987)).

Village of Rosemont v. Priceline.com Inc., in which the plaintiff, the Village of Rosemont, taxed rental hotel and motel rooms within the Village of Rosemont at a rate of 7%, but did not tax other rental charges added to the bill, provides insight into how a court would analyze the dormant Commerce Clause test presented in *Overstock.com*.[195] The plaintiff alleged the defendants, various online travel companies who book hotel rooms for guests via the Internet, were owners[196] of hotels under the ordinance and, therefore, their services were taxable as part of the room rental rate.[197] The court ultimately held because the transactions were for the use of tangible personal property, and not services, the hotel tax was a valid use tax, not an impermissible occupation tax.[198] Thus, the Ordinance did not violate the Commerce Clause, ITFA, or the Due Process and Equal Protection Clauses.[199] In contrast, Chicago's amusement tax and Pasadena's utility tax do not involve taxing a tangible good.[200] However, the court's analysis in *Village of Rosemont* can aid the analysis the court should use in *Labell v. City of Chicago* by noting the differences in applicability.[201]

The discussion will begin with the defendants' dormant Commerce Clause and ITFA defenses.[202] In applying the four-prong dormant Commerce Clause test articulated in *Overstock.com*, the court found all four prongs of the test were satisfied, and therefore, the tax was valid.[203] First, the court in *Village of Rosemont* found a nexus was present because the tax was collected in conjunction with the rental of a hotel room in the Village of Rosemont, and the fact that the room was paid for over the Internet, as opposed to in person, did not have any bearing on whether a nexus existed.[204] The second factor, fair

195. *See* Vill. of Rosemont v. Priceline.com Inc., No. 09 C 4438, 2011 WL 4913262, at *1 (N.D. Ill. Oct. 14, 2011) (citing ROSEMONT, ILL., ORDINANCE § 10-23(a)).

196. The definition of owner under Rosemont Ordinance § 10-22 is "any person (a) having 'an ownership interest in [a hotel],' (b) 'conducting the operation of a hotel' or (c) 'receiving the consideration for the rental of such hotel or motel room.'" *Vill. of Rosemont*, 2011 WL 4913262, at *2 (quoting ROSEMONT, ILL., ORDINANCE § 10-22).

197. *Id.* at *2.

198. *Id.* at *5.

199. *Id.* at *5–6.

200. CHICAGO, ILL., MUNICIPAL CODE § 4-156-020(B); PASADENA, CA. CODE OF ORDINANCES, ch. 4.56.070(A).

201. *Vill. Of Rosemont*, 2011 WL 4913262, at *5–6.

202. *See id.* at *5–11.

203. *Id.* at *5 ("A state tax withstands a dormant Commerce Clause challenge so long as the tax: '[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.'" (quoting Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977))).

204. *Id.* at *7.

apportionment, was satisfied because the use "can only occur in one place—the Village of Rosemont. Thus, no other state or municipality can levy a tax on this 'use.'"[205] Moreover, the third factor, whether the tax discriminates against interstate commerce, was satisfied because the "tax is applied at the same rate on every hotel reservation transaction in Rosemont, regardless of where the reservation is made or payment occurs."[206] Finally, the last prong, whether the tax is related to services provided in the state, was satisfied because, by renting a hotel in the Village of Rosemont, the consumer had the protection of Illinois' police and fire protections, as well as "the State's maintenance of a civilized society."[207]

In contrast, Chicago's amusement tax in *Labell v. City of Chicago* and Pasadena's utility tax would not satisfy the four-step dormant Commerce Clause test.[208] In determining the first factor of whether a substantial nexus existed, there was a tangible hotel room in the case of *Village of Rosemont*,[209] which helped satisfy the physical presence requirement. By contrast, online streaming and video services are intangible. Additionally, the second prong is not satisfied in *Labell v. City of Chicago* or for Pasadena's utility tax, because the tax can be applied in more than one place.[210] Citizens of Chicago may have residences in other locations. Therefore, if other cities decided to adopt this tax, citizens would be subjected to multiple taxes for the same services. The third factor would not be satisfied in *Labell v. City of Chicago* or in Pasadena because the 9% amusement tax is not imposed at the same rate as the 7% in-state sales tax, and the 9.4% utility tax is higher than California's 6% in-state sales tax. Lastly, the final factor of the test would not be satisfied in *Labell v. City of Chicago* or in Pasadena because the taxpayer does not benefit from services provided in Illinois or Chicago, such as gaining protection from the state's police and fire forces or the state's maintenance of a civilized society, as the service is provided only online.

The second relevant defense the defendants in *Village of Rosemont* raised was that the hotel tax in question violated ITFA, since the tax "is discriminatory because it does not apply to traditional travel agents,

205. *Id.* (citing Brown's Furniture, Inc. v. Wagner, 665 N.E.2d 795, 804 (Ill. 1996)).

206. *Id.* at *8 (referencing D.H. Holmes Co. v. McNamara, 486 U.S. 24, 31 (1988) where the Court held "that use tax does not discriminate against interstate commerce when imposed at the same rate as an in-state sales tax").

207. *Id.* (quoting Okla. Tax Comm'n v. Jefferson Lines, Inc. 514 U.S. 175, 200 (1995)).

208. *See* First Amended Complaint, *supra* note 121, ¶¶ 105–09.

209. *Vill. of Rosemont*, 2011 WL 4913262, at *1.

210. *See* First Amended Complaint, *supra* note 121, ¶ 106.

who perform the same function as [online travel services] do."[211] Furthermore, since ITFA "prohibits a state from enacting a discriminatory tax on electronic commerce," it is invalid.[212] The court in *Village of Rosemont* disagreed with the defendant because the travel agents in question operate differently than non-online travel agents, and thus, the village of Rosemont's failure to implement a tax on the fees of other travel agents is not discriminatory.[213]

The same issue presents itself in *Labell v. City of Chicago* and in Pasadena's utility tax. However, the outcome is different. Chicago's amusement tax and Pasadena's utility tax are discriminatory because they do not apply to anyone who does not reside in Chicago or Pasadena, even though outsiders are using the same Internet streaming video, audio or gaming services.[214] Chicago's amusement tax is also discriminatory because Chicago citizens are paying a 9% sales tax[215] and Pasadena citizens are paying a 9.4% tax,[216] whereas the majority of Americans are not paying a tax on these services at all.[217] Since ITFA "prohibits a state from enacting a discriminatory tax on electronic commerce," Chicago's amusement tax violates ITFA.[218] Although the same argument was presented in *Village of Rosemont* as in *Labell v. City of Chicago*, the court's conclusion in *Labell v. City of Chicago* should differ from that in *Village of Rosemont* because there is no difference in operation between streaming services in cities that are taxed and cities that are not, as opposed to the difference in operation between travel agents online and in person in *Village of Rosemont*.[219] Anyone who uses online streaming audio, visual or gaming services in the United States is receiving the service in the same manner. Thus, citizens of Chicago are being discriminatorily taxed, in violation of ITFA and the Commerce Clause.

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211. *Vill. of Rosemont*, 2011 WL 4913262, at *9.
212. *Id.* (citing ITFA § 1102(a)(2)).
213. *Id.*
214. *See* Complaint, supra note 99, ¶ 22; PASADENA, CAL., CODE OF ORDINANCES § 4.56.070(A) (2016) (limiting the tax to those within the city).
215. *Id.*
216. Henry, *supra* note 17.
217. Kerry Close, *If You Live in One of These Cities, You May Have to Pay a Netflix Tax*, TIME MONEY (Oct. 4, 2016), http://time.com/money/4518535/california-netflix-tax.
218. *See* Vill. of Rosemont v. Priceline.com Inc., No. 09 C 4438, 2011 WL 4913262, at *9 (N.D. Ill. Oct. 14, 2011) (citing ITFA § 1102(a)(2)).
219. *See id.* at *11; Complaint, *supra* note 99, ¶ 8, 12, 15.

VII. ADDITIONAL CONSTITUTIONAL ARGUMENTS

Additional constitutional principles also apply to taxes similar to Chicago's amusement tax and Pasadena's utility tax, such as the Due Process Clause and the Equal Protection Clause. Each will be discussed in turn in the following sections. In order to understand the Constitutional arguments that should be considered in *Labell v. City of Chicago* and other similar cases, such as that which may be filed in Pasadena, it is essential to first understand the basis of the Due Process Clause and the Equal Protection Clause. These arguments can be applied to Chicago's 9% amusement tax on streaming services and Pasadena's 9.4% utility tax on video services.

A. General Principles

The Due Process Clause is found in both the Fifth Amendment and Fourteenth Amendment of the United States Constitution.[220] The Fifth Amendment applies to the Federal government, and the Fourteenth Amendment applies to the states.[221] Because the Due Process Clause is included in the Bill of Rights, it applies to the states.[222] Both the Fifth Amendment and Fourteen Amendment state no person shall be "deprived of life, liberty, or property, without due process of law."[223] The purpose of the Due Process Clause is to ensure "all levels of American government . . . operate within the law . . . and provide fair procedures."[224] In addition to ensuring that citizens are not deprived of "life, liberty, or property, without due process of law,"[225] the Due Process Clause also ensures "the government observe[s] or offer[s] fair procedures, whether or not those procedures have been provided for in the law on the basis of which it is acting."[226]

The Equal Protection Clause is found in the Fourteenth Amendment of the United States Constitution and "prohibits states from denying any person within its [jurisdiction] the equal protection of

220. U.S. CONST., amend. V; U.S. CONST., amend. XIV. It is clear that since the Due Process Clause is mentioned twice in the Constitution, it is a "central proposition." Peter Strauss, *Due Process*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/due_process (last visited June 1, 2017).

221. Strauss, *supra* note 220.

222. *Id.* ("These decisions almost obliterated any difference between the Bill of Rights and the Fourteenth Amendment.").

223. U.S. CONST., amend. V; U.S. CONST., amend. XIV § 1.

224. Strauss, *supra* note 220.

225. U.S. CONST., amend. V; U.S. CONST., amend. XIV § 1.

226. Strauss, *supra* note 220.

the laws."[227] The Equal Protection Clause ensures an "equal application" of the laws.[228] Additionally, courts have found the Due Process Clause of the Fifth Amendment "require[s] the federal government to afford equal protection of the laws."[229] Usually a determination of whether there has been a violation of the Equal Protection Clause "arises when a state grants a particular class of individuals the right to engage in an activity yet denies other individuals the same right."[230] The Supreme Court of the United States has developed tests to determine whether the Equal Protection Clause has been violated.[231] The test that courts generally apply, and the test that would apply to Chicago's Amusement Tax, is whether the "state classification . . . has 'a rational basis' to a 'legitimate state purpose.'"[232]

B. As Applied to Chicago's Amusement Tax and Pasadena's Utility Tax

In *Village of Rosemont*, the defendants alleged the tax in question was invalid under the Due Process and Equal Protection Clauses.[233] First, an analysis of the Due Process Clause is necessary. The defendants in *Village of Rosemont* contended various terms in the hotel tax were vague and that "a reasonable person of ordinary knowledge could [not] determine whether the terms apply to them."[234] This specific argument, however, does not apply, as the definition of "amusement" in the Chicago City Ordinances is not vague.[235] Instead, in *Labell v. City of*

227. *Equal Protection*, LEGAL INFO. INS., https://www.law.cornell.edu/wex/Equal_protection (last visited June 1, 2017); *see also* U.S. Const. amend. XIV.

228. *See Equal Protection*, *supra* note 227 ("The equal protection clause is not intended to provide 'equality' among individual or classes.").

229. Strauss, *supra* note 220.

230. *14th Amendment Equal Protection Clause*, GETLEGAL.COM, http://public.getlegal.com/legal-info-center/14th-amendment-equal-protection-clause/ (last visited June 1, 2017).

231. *Id.*

232. *Id.* However, in some cases, the Court will apply a test of "strict scrutiny" if the "state law or its administration is meant to discriminate." *Id.* "Usually, if a purpose to discriminate is found, the classification will be strictly scrutinized if it is based on race, national origin, or, in some situations, citizenship" or "if the classification interferes with fundamental rights, such as First Amendment rights, the right to privacy or the right to travel." *Id.*

233. Vill. of Rosemont v. Priceline.com Inc., No. 09 C 4438, 2011 WL 4913262, at *9–10 (N.D. Ill. Oct. 14, 2011).

234. *Id.* at *10.

235. *See* CHI., ILL. MUN. CODE § 4-156-010 (1990). The ordinance defines "amusement" to include three categories. First, amusement means "any exhibition, performance, presentation or show for entertainment purposes." Second, amusement means "any entertainment or recreational activity offered for public participation or on a membership or other basis." Third, amusement means "any paid television programming." The

Chicago, procedural Due Process was violated when the Comptroller of the City of Chicago expanded the already existing amusement tax, which originally made no mention of Internet streaming services, without a vote.[236] By expanding the amusement tax through Amusement Tax Ruling No. 5, instead of allowing the city council to vote on the tax, the citizens of Chicago were deprived of due process. Similarly, Pasadena attempted to expand its utility tax, which was voted on by its citizens in 2008, to include online video services in 2017.[237] Therefore, Pasadena's utility tax as applied to online streaming services also violates the Due Process Clause.

Second, the defendants in *Village of Rosemont* "argue[d] that the Ordinance violate[d] their equal protection rights because there [was] no rational basis for including them in the definition of 'owner' but excluding travel agents and other travel intermediaries."[238] The court in *Village of Rosemont* recognized "Federal and State guarantees of equal protection require only that there be a rational basis for the differential treatment of those taxed and those not taxed."[239] The court also noted "[a] classification for taxation purposes carries a strong presumption of validity, and it will survive a challenge on equal protection grounds unless the party asserting the challenge negates every conceivable basis for the classification."[240] For this reason, the court in *Village of Rosemont* disagreed with the defendants because customers using online travel services "get the right to occupy a hotel room in Rosemont only if they pay defendants' fees, which is not true for customers of travel agents. Therefore, the defendants receive the consideration for the rooms, while travel agents do not."[241]

In contrast, the plaintiffs in *Labell v. City of Chicago*, or potentially in Pasadena, if an Equal Protection Clause argument was asserted, would be more likely to prevail than the defendants in *Village of Rosemont*. This is because, as previously discussed, there is no difference between streaming services provided to consumers in

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ordinance also provides specific non-limiting examples of each category of amusement. Under the standards set forth for vagueness in *Village of Rosemont*, this detailed definition of "amusement" would not be considered vague. *Vill. of Rosemont*, 2011 WL 4913262, at *10 (quoting Coats v. City of Cincinnati, 402 U.S. 611, 614 (1971)) ("A statute is vague only if 'men of common intelligence must necessarily guess at its application or meaning.'").

236. Shapiro, *supra* note 79.

237. Henry, *supra* note 17.

238. *Vill. of Rosemont*, 2011 WL 4913262, at *10.

239. *Id.* (quoting N. Pole Corp. v. Vill. of E. Dundee, 635 N.E.2d 1060, 1066 (Ill. App. Ct. 1994)).

240. *Id.* (quoting Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 364 (1973)).

241. *Id.* at *11.

Chicago and streaming services provided to the rest of the United States. These plaintiffs would therefore have a stronger argument than the defendants did in *Village of Rosemont*.

Because of the strong arguments supporting a violation of the dormant Commerce Clause, the Due Process Clause, and the Equal Protection Clause of the United States Constitution in favor of the plaintiffs in *Labell v. City of Chicago*, and since similar cases have asserted the same arguments, the plaintiffs' Complaint in *Labell v. City of Chicago* would have been stronger if they had added these constitutional arguments.[242]

VIII. POLICY CONSIDERATIONS TO KEEP THE INTERNET TAX FREE

Although Americans are accustomed to enjoying free Internet access, cities cannot ignore their financial struggles caused by the massive move towards e-commerce. About twenty years ago, goods Americans now access through streaming services were provided from video rental and music stores.[243] These stores paid property taxes, municipal sales taxes, and other duties, allowing cities to gain financially.[244] With Americans now able to acquire these services electronically, the annual revenue of cities have substantially declined.[245] Nevertheless, for the following reasons, cities should not tax Internet access, including streaming services.

A. Policy Reasons in Favor of Not Circumventing ITFA

Despite financial concerns, taxing Internet access may not be the most effective way to account for cities' financial deficits. Internet economy in America during the year 2016 was "estimated to comprise 5.4 percent of U.S. GDP."[246] However, studies show that if Internet access becomes taxable, approximately twenty million Internet users could be deterred from using the Internet, is a loss equal to four years of Internet growth.[247] Thus, the purpose of enacting ITFA would be

242. *See id.* at *2–10.

243. Russell Brandom, *Chicago's 'Cloud Tax' Makes Netflix and Other Streaming Services More Expensive*, THE VERGE (July 1, 2015, 10:22 AM), http://www.theverge.com/2015/7/1/8876817/chicago-cloud-tax-online-streaming-sales-netflix-spotify.

244. *Id.*

245. *Id.*

246. Erik Cederwall, *The Internet Tax Freedom Act and the Internet Economy*, TAX FOUND. (Oct. 27, 2014), http://taxfoundation.org/blog/internet-tax-freedom-act-and-internet-economy.

247. *Id.*; *see also* GEORGE S. FORD, PHOENIX CTR. FOR ADVANCED LEGAL & ECON. PUB. POLICY STUDIES, SHOULD THE INTERNET TAX MORATORIUM BE MADE PERMANENT? 3–4

defeated, and revenues gained from Internet economy would be diminished.[248]

Chicago and Pasadena are some of the first cities to attempt to tax Internet access, despite the permanent passage of ITFA,[249] but many cities have chosen not to enact similar taxes.[250] For example, cities in Alabama and Vermont, who contemplated enacting similar taxes as the tax in Chicago, were deterred after finding cloud and streaming services were "more akin to a service than a tangible good," and taxing these services would violate federal legislation.[251] Accordingly, Chicago should follow the lead of these states, as more and more states are unable to justify taxing Internet access.

Moreover, if courts hold that states are able to validly tax Internet access, the tax could amount to more than 20% of a user's overall bill.[252] This would create a large burden for both Internet users and Internet providers.[253] This large tax percentage could dissuade the public from using the Internet, causing a negative effect on state—and possibly national—economies.[254]

(2014) ("If the effective tax rate was 10%, then six years of fixed-line growth would be reversed, returning the adoption rate to the level observed in 2008.").

248. *See* FORD, *supra* note 247, at 3–4.

249. *See supra* notes 17–18 and accompanying text.

250. Mark Peters & Greg Bensinger, *States Eye Taxes on Streaming Video and Cloud Computing*, WALL ST. J. (last updated Aug. 20, 2015, 3:13 PM), http://www.wsj.com/articles/states-eye-taxes-on-streaming-video-and-cloud-computing-1440095146 ("Tennessee [has also] expanded its 7% sales tax to software and digital games that are accessed remotely.").

251. *See id.* "Vermont . . . issued a publication stating that computer memory is tangible personal property." JENSEN, *supra* note 10, at 6. The speculation is that the language was removed due to pressure from political groups. *Id.*; *see generally* VT. DEP'T OF TAXES, TECHNICAL BULLETIN: TREATMENT OF COMPUTER SOFTWARE AND SERVICES 1–3 (2011), http://www.mwe.com/files/Uploads/Documents/News/VermontTB-54.pdf (discussing Vermont state taxation of "computer software and services").

252. Monty Tayloe, *Moratorium on Internet Access Tax Should Become Permanent, Say CTIA, Coalition*, INST. FOR POL'Y INNOVATION (Oct. 23, 2013), http://www.ipi.org/ipi_issues/detail/moratorium-on-internet-access-tax-should-become-permanent-say-ctia-coalition. The Internet Tax Freedom Act Coalition, which includes NCTA, NTCA, T-Mobile, and Amazon, believes ITFA should become permanent, as the taxes that would be implemented if ITFA expired "would hurt the growth of the wireless industry and price out lower-income consumers." *Id.* The Internet Tax Freedom Act Coalition estimates the average tax rates on telephone and voice services are currently 17%, and the average tax rates on cable and video services are approximately 12%, which are substantially higher than the average general sales tax rate of approximately 7%. *The Issue: Keep Access to the Internet Free from Taxation*, INTERNET TAX FREEDOM ACT COALITION, https://web.archive.org/web/20150815163827/itfacoalition.org/the-issue (last visited June 1, 2017).

253. Tayloe, *supra* note 252.

254. *See supra* notes 244–45 and accompanying text.

Expanding Chicago's amusement tax is estimated to only produce approximately $12 million annually, leaving the question of whether the tax is even worth imposing.[255] Even if $12 million is collected from the amusement tax, Chicago's actual revenue increase will be less, since surcharges must be deducted and the price increase would likely cause subscribers of streaming services to cancel their subscriptions.[256] Pasadena's utility tax is estimated to produce even less revenue from streaming services—only $2.3 million.[257] Thus, companies will be faced with the decision to either charge their customers the taxes or absorb the costs internally.[258]

Furthermore, it would be difficult for cities and states to keep up with the rapid development of the Internet, thus impacting their ability to effectively tax Internet usage and services. The cost of regulating this tax may be more burdensome than beneficial to Chicago, Pasadena, and other cities considering taxation. Cities and states would perpetually struggle to stay abreast of new developments in the Internet; by the time their Internet tax laws were amended, another change would occur.[259] Moreover, streaming services are frequently used on portable devices, such as laptops, cellphones, or tablets.[260] Thus, citizens of Chicago and Pasadena may frequently use these services when traveling outside of the city. In the end, cities such as Chicago and Pasadena may incur a net loss by spending resources to determine when their citizens are using these services within city limits, and when they are using these services outside of the city.[261] Since streaming services and cloud computing are based on "borderless global networks," the location of these services are difficult to define, and thus, the taxes that apply to the usage of these services will be hard, if not impossible, to determine and effectively govern.[262] Additionally, if these services are "bundled," cities and states would have to determine whether the

255. Shapiro, *supra* note 79.

256. *Id.* Based on a poll conducted by the Huffington Post in May 2014, half of Netflix users polled said they would discontinue service if the price increased by $2 a month, and one fifth of Netflix users surveyed said they would discontinue service if the price increased by $1. *Id.*; Timothy Stenovec & Emily Swanson, *Even a $2 Price Hike Could Send Netflix Customers Running*, HUFFINGTON POST: TECH (May 7, 2014, 8:56 AM), http://www.huffingtonpost.com/2014/05/07/netflix-price-increase_n_5275960.html.

257. Peltz, *supra* note 93.

258. *See* Shapiro, *supra* note 79.

259. *See* JENSEN, *supra* note 10, at 5.

260. *See supra* notes 11–12 and accompanying text.

261. *See* JENSEN, *supra* note 10, at 5.

262. *Id.*

services amount to more than 50% of the user's total bill, and are therefore taxable, causing an additional burden.[263]

On a larger scale, for Chicago, Pasadena, and other cities or states that are considering adopting similar laws, Internet users may be deterred from moving to these areas or continuing to live in these areas if citizens are charged for using streaming services, since using Internet services is an integral part of daily American life.[264] A decrease in the number of residents would cause cities such as Chicago and Pasadena to lose even more revenue.[265] Since the Internet is so ingrained in the average American lifestyle—and because, for approximately the last fifteen years, Americans have enjoyed this amenity for free—it is possible that when choosing a residence, Americans would consider where Internet usage and services are free.[266]

Taxing the Internet is not the only way for cities to generate revenue.[267] Taxing the Internet might be an easy way for cities to increase their budgets, but there are other alternatives available to cities and states. For example, ITFA does not prevent cities and states from applying sales tax to physical goods sold over the Internet, as long as the same tax would be applied to the good if purchased in a store.[268] Even though state and local sales tax may be used on goods ordered over the Internet, many states currently do not apply such taxes because, in order to do so, the seller must have a physical presence in the specified states.[269] States could both generate revenue and find

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263. *See supra* notes 85–88 and accompanying text.

264. *See* Amy Korte, *42% of Illinoisans Would Like to Move to Another State, Gallup Poll Shows*, ILL. POL'Y (Feb. 17, 2016), https://www.illinoispolicy.org/42-of-illinoisans-would-like-to-move-to-another-state-gallup-poll-shows/.

265. *See id.*

266. *See id.*

267. *See id.*

268. MICHAEL MAZEROV, CTR. ON BUDGET & POL'Y PRIORITIES, MAKING THE "INTERNET TAX FREEDOM ACT" PERMANENT COULD LEAD TO A SUBSTANTIAL REVENUE LOSS FOR STATES AND LOCALITIES 2 (2007), http://www.cbpp.org/sites/default/files/atoms/files/7-11-07sfp.pdf.

269. *Id.* "This is due to a 1992 U.S. Supreme Court decision that held that a state cannot require an out-of-state merchant to charge sales tax to the state's residents unless the seller has a physical presence, such as a warehouse or call center, within the state's borders." *Id.*; *see also* Quill Corp. v. North Dakota, 504 U.S. 298, 311–12 (1992) (holding that a state violates the Commerce Clause where it taxes an out-of-state merchant that does not have a "substantial nexus" to the taxing state). "ITFA deals specifically with taxes on Internet access, and multiple or discriminatory taxes on electronic commerce, while the issues related to taxing interstate electronic commerce center largely on the Supreme Court's decision in *Quill Corp. v. North Dakota* and the Commerce and Due Process Clauses of the Constitution." STUPAK, *supra* note 13, at 4.

ways to encourage merchants to have a physical presence, which would, in turn, also produce other revenue for the state.[270]

B. Rebutting Arguments in Favor of Taxing the Internet

Although many Internet users believe the Internet should remain tax-free,[271] there are also proponents of allowing the Internet to be taxed.[272] None of these arguments, however, overcome the reasons the Internet should remain tax-free. Proponents who do not want to adopt ITFA permanently, but prefer Internet taxation, argue ITFA's definition of "Internet access" is too broad, and that states and localities will never be able to tax online services, prohibiting them from collecting potentially large amounts of revenue.[273] Additionally, proponents argue eliminating the grandfather clause deducts revenue from states and localities that have depended on the tax for many years.[274] Therefore, these states and localities would have to either cut programs to deal with the deficit, or have to make up the funds by raising taxes elsewhere.[275] It is estimated the states grandfathered into ITFA would lose between approximately $80 million and $120 million in annual revenue.[276] This does not create a different scenario, however, from those states unable to tax Internet access and have had to find other ways to generate revenue.[277]

Additionally, some sources argue the purpose of ITFA was to allow the Internet to expand.[278] Approximately 87% of the American population now uses the Internet.[279] Thus, proponents of Internet taxation argue the Internet no longer needs help expanding, and ITFA is no longer necessary.[280] As previously discussed, Internet taxation

270. *See* MAZEROV, *supra* note 268, at 2.
271. *See* Peltz, *supra* note 93.
272. *See, e.g.*, MAZEROV, *supra* note 268, at 1.
273. *Id.*
274. *Id.* at 1–2.
275. *See id.* at 4.
276. *Id.*
277. *See supra* notes 267–70 and accompanying text.
278. MAZEROV, *supra* note 268, at 4–5.
279. *United States of America Internet Usage and Broadband Usage Report,* INTERNET WORLD STATS, http://internetworldstats.com/am/us.htm (last visited June 1, 2017).

> Making the 1998 "Internet Tax Freedom Act" permanent—as proposed by S. 156/ H.R. 743—could adversely affect state and local government revenues, and therefore the availability of funds for important services . . . [by] [d]epriv[ing] nine states of $80m[illion]–$120m[illion] in annual revenues from non-discriminatory and heretofore grandfathered taxes on Internet access services.

MAZEROV, *supra* note 268, at 1.
280. MAZEROV, *supra* note 268, at 4–5.

would cause a decrease in the use of the Internet, defeating the original purpose of ITFA.[281] Additionally, proponents of not adopting ITFA argued that permanent passage of ITFA would breach its original intention, which was to only ban taxing Internet access for three years.[282] Conversely, almost twenty years have passed since the enactment of ITFA, and only a scarce number of Internet users are calling for Internet taxation.

Moreover, proponents of Internet taxation argue the sale of DVDs, Blu-rays, video games, and CDs has rapidly declined, causing states to lose a substantial amount in tax revenue from these items.[283] Thus, proponents of Internet taxation argue making ITFA permanent will now prevent states and cities from "extending their normal sales taxes to music, movies, and television programming delivered over the Internet, which is rapidly becoming a major marketplace for such services."[284]

Finally, proponents of Internet taxation argue by making ITFA permanent, Internet access providers are now able to avoid "a host of general taxes that other businesses must pay, such as sales taxes on equipment purchases."[285] But the permanent passage of ITFA only deals with taxation of Internet usage and access itself, not general taxes that come with it.[286] Moreover, the growth of "renting online computing storage and using remote Internet-connected servers for number crunching" may create an even larger tax deficit for states.[287] Again, this expansion of Internet users is the exact reason that ITFA was enacted, and thus, should be encouraged, not deterred.

In sum, if Congress did not pass TFTEA, all Internet usage would have become taxable, creating a detriment to the growth of the Internet. The potential for cities to raise tax revenue would likely have been destroyed because Internet users may have moved away from using the Internet, causing a large deficit in e-commerce and the economy in general. Thus, the passage of the TFTEA, which made ITFA permanent, was essential to ensure Internet usage would continue to expand.

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281. *See supra* notes 252–54 and accompanying text.

282. MAZEROV, *supra* note 268, at 5. Additionally, "[a]ll of the 14 developed nations that have achieved a higher rate of household broadband adoption." *Id.* at 1.

283. Peters & Bensinger, *supra* note 250.

284. MAZEROV, *supra* note 268, at 1.

285. *Id.* "Studies by GAO and U[niversity] of Tennessee economists show that existing taxes on Internet access have not adversely affected household subscriptions to access or the availability of broadband access in particular locations." *Id.*

286. *See supra* notes 53–60 and accompanying text.

287. Peters & Bensinger, *supra* note 250.

IX. CONCLUSION

Taxing Internet access unnecessarily burdens a free form of information and entertainment Americans have enjoyed tax-free for almost twenty years and would directly violate the purpose of ITFA. Although taxing the Internet may seem to be an easy solution to fix cities' revenue deficits, it may actually create more long-term problems. Since the passage of ITFA, cities have found other avenues in which to generate revenue, and in the end, the permanency of tax-free Internet services will not deprive cities of any revenue. Ultimately, as demonstrated by this Note's analysis of *Labell v. City of Chicago*, allowing the taxation of the Internet, especially at a higher rate, not only raises policy concerns but violates IFTA, as made permanent federal legislation through TFTEA, as well as the U.S. Constitution, and therefore, no court should hold that taxing video and streaming services is permissible.

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