




# States' Problems with the Internet Tax Freedom Act

FTA Annual Meeting  
Providence, RI  
June 8, 2004




## The moratorium/preemption

47 U.S.C. §151, note, §1101:

- (a) Moratorium. – No State or political subdivision thereof shall impose any of the following taxes during the period beginning October 1, 1998, and ending on November 1, 2003 –
- (1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998, and
  - (2) multiple or discriminatory taxes on electronic commerce.

(Originally enacted in 1998 for a three-year period, extended in 1998 for another two years; expired November 1, 2003.)



**Issues presented for state and local governments**

- (a) Why? What possible rationale?
- (b) What's *not* covered
- (c) ACEC
- (d) "multiple and discriminatory taxes"
- (e) Grandfather clause
- (f) Taxes covered
- (g) Definition of "Internet access"



**ITFA definition of "Internet access"**

The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services.

### First-sentence issues

“The term ‘Internet access’ means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users.”

- ? **Meaning of “access.”** An American Heritage dictionary offers the following first two definitions of “access”: “1. A means of approaching or entering; passage. 2. The right to enter or make use of ...”
- ? **First-clause issues:** What’s included in “content, information, electronic mail, or other services offered over the Internet”?  
Maybe easier: What would *not* be included?
- ? **Second-clause issues:** What’s included by “and may also include access to proprietary content, information, and other services as part of a package of services offered to users” *beyond* what’s included in the first clause?

### Second-sentence issues

The term “Internet access” means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. ***Such term does not include telecommunications services.***

- Definition of “telecommunications services”
- Discrimination among providers
- Original intent of this provision

### Sharing the pain – alternative approaches

**Pure POP:** The term "Internet access" means a service that first connects retail users to a server on the Internet. **Or:** The term "Internet access" means a service, regardless of the medium through which such service is delivered, that connects retail users to an initial point of presence on the Internet.

**POP-Plus/Qualitative:** The term "Internet access" is defined as the function of connecting a user to the Internet, electronic mail, and the ability to search the Internet for information but does not include content, information, or other services purchased by the user either with Internet access or separately.

**Qualitative/List:** The term "basic Internet access" means a service that enables users to access content, information and electronic mail offered over the Internet. "Basic Internet access" does not include the provision of telecommunications services, television programs, games, books, music, motion pictures and other such products and services, or products and services that are also available for purchase in any form other than over the Internet."

### H.R. 49 and S. 150 as amended

The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services, *except to the extent such services are used to provide Internet access.*

Issues:

- Backbone, middle mile, last mile
- The Loop
- VoIP

## Mything the point: Part 1

### Senate Commerce, Science, and Transportation Committee Report on S. 150 (S. Rept. No. 108-155):

- “[T]he modified definition of Internet access is not meant to affect State and local taxation of traditional telecommunications services and other services that are not used to provide Internet access.”
- “The Committee intends that this clarification will be narrowly construed to include only those telecommunications services that are actually being used to provide Internet access.”

## Translation, with The Loop

“The Committee intends that this clarification will be narrowly construed to include only those telecommunications services that are actually being used to provide *Internet access*.”

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“The term *‘Internet access’* means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services.”

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“The Committee intends that this clarification will be narrowly construed to include only those telecommunications services that are actually being used to provide *a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users.*”



### Why this worries states

Michael K. Powell, the chairman of the Federal Communications Commission, recently stated, “We think pretty quickly there’s no reason why virtually any communication service [won’t be Internet-based].”

*The Wall Street Journal* recently reported that some telecommunications industry executives predict that VoIP “will eventually replace the circuit-switch technology that telephone networks have used for more than a century.”



### More than a loop – a death spiral

Adding back in the amended second sentence, the Senate Report’s statement becomes:

“The Committee intends that this clarification will be narrowly construed to include only those telecommunications services that are actually being used to provide *a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users* **[including only those telecommunications services that are used to provide a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users].”**

### **Managers' amendment to S. 150**

The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. The term "Internet access" does not include telecommunications services, *except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.*

Issue: But for POTS, any real difference from amendment to H.R. 49 and S. 150?

### **Carper-Alexander (S. 2084)**

The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. The term "Internet access" does not include telecommunications services, *except to the extent such services are purchased, used, or sold by an Internet access provider to connect a purchaser of Internet access to the Internet access provider.*

## **Mything the point: Part 2**

- *“You’ve got e-mail” becomes “You owe taxes”*
- *An unbundling provision solves all of the state’s problems: “If charges for Internet access are aggregated with and not separately stated from charges for products or services that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access service provider can reasonably identify charges not subject to taxation from its books and records that are kept in the regular course of business.”*
- *Taxing DSL is illegal, “bad behavior” by the states.*
- *“The bill does not affect VoIP at all,” said an aide to Senator Allen recently.*

## **The Texas approach**

(a) MORATORIUM.- No State or political subdivision thereof shall impose any of the following taxes —

Sales and use taxes on charges for Internet access in an amount not to exceed the first \$\_\_\_ of a monthly charge for Internet access, without regard to whether the Internet access is bundled with another service, including any other taxable service, or to the billing period used by the service provider. This moratorium applies to the total sales price the service provider charges for Internet access to a purchaser, without regard to whether the service provider charges one lump-sum amount or separately bills the purchaser for each user ...



## **A simple, workable, creative and intelligent alternative**

(A) The term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as part of a package of services offered to users. Such term does not include telecommunications services, except to the extent that such services:

- (i) are purchased directly by a retail purchaser of Internet access service solely for the purpose of connecting to an initial point of presence on the Internet, or
- (ii) are purchased by a provider of Internet access service for the purpose of being resold to that provider's retail purchasers of Internet access service solely for the purpose of enabling those purchasers to connect to an initial point of presence on the Internet.

(B) Notwithstanding subsection (A) above, "Internet access" does not include the following items, unless they are predominantly made accessible over the Internet without additional charge to purchasers of Internet access service:

- (i) products and services that are not directly purchased by the retail purchaser of the Internet access service, or by a provider of such service for resale to its Internet access service purchasers, solely for the purpose of allowing the retail purchaser to obtain access to the activity described in subsection (A); or
- (ii) products and services the substantial equivalents of which are available for purchase and use in any form other than over the Internet.

## **Recent developments**

Senate passage of S. 150 on April 29, 2004:

- ? Extends moratorium four years, with a two-year moratorium for revised definition of Internet access (i.e., DSL).
- ? Amends second sentence of definition of Internet access as per managers' amendment of S. 150: "The term "Internet access" does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access."
- ? Adds: "Sec. 1108. Exception for voice services over the Internet. 'Nothing in this Act shall be construed to affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol. This section shall not apply to any services that are incidental to Internet access, such as voice-capable e-mail or instant messaging.'"

Political action remaining: Conference with House?