2015 POLICY BRIEF

NACo NATIONAL ASSOCIATION of COUNTIES

PROTECT COUNTY TAXING AUTHORITY: SUPPORT A SHORT-TERM EXTENSION OF THE INTERNET TAX FREEDOM ACT (ITFA)

ACTION NEEDED: Urge your members of Congress to support a short-term extension of the Internet Tax Freedom Act (ITFA), in lieu of permanent measures like the Permanent Internet Tax Freedom Act (H.R. 235) or the Internet Tax Freedom Forever Act (S.431). This measure would permanently preempt state and local tax authority over the constantly evolving industry of Internet access service.

WHY COUNTIES CARE: The original intent of ITFA, enacted in 1998, was to encourage the early growth of the Internet by preventing state and local governments from taxing Internet access or levying other Internet-only taxes. At the time, state and local governments did not disagree with the general principle behind the legislation, but were wary of the impact that a preemption of state and local authority would have on our system of federalism. However, the justification that the Internet is a growing technology is no longer applicable given the massive advancements in the technology since 1998, and state and local governments' taxing authority should not continue to be preempted in this arena.

BACKGROUND: In 1998, Congress passed ITFA (P.L. 105-277), which imposed a three-year moratorium on state and local taxation of Internet access and prohibited multiple or discriminatory taxes on electronic commerce. In general, taxation of Internet access refers to applying state and local taxes to the monthly charge that subscribers pay for access to the Internet through an Internet Service Provider (ISP). Providing tax-free Internet access was intended to help stimulate the development of this new technology. State and local taxes on Internet access that were in effect prior to 1998 were "grandfathered in" by the ITFA; this provision continues today. The ITFA was renewed in 2001, 2004 and most recently in 2014 through the Consolidated and Further Continuing Appropriations Act of 2015 (P.L.113-235), which extended the moratorium until October 1, 2015.

QUICK FACTS

- **The Pew Research Center estimates that in 2013, 86 percent of American adults use the Internet, up from 14 percent in 1995**
- **There are ten states that are "grandfathered in" and are currently able to collect taxes on Internet access: Hawaii, New Hampshire*, New Mexico, North Dakota, Ohio, South Dakota, Texas, Washington*, Wisconsin and Tennessee***
  Denotes states not currently collecting
- **For FY 2013, New York City collected over $131.5 million dollars in cable franchise fees**
- **Rockdale County, Georgia (pop: 85,820) collects $51,000 per month on cable franchise fees**

The moratorium prohibiting taxation of Internet access and multiple or discriminatory taxes on e-commerce may seem positive, but given the advancements in technology, the issue has become much more complicated as it relates to state and local tax structures. Currently, "Internet access" and "Internet access service" are defined in a way that allows sellers of "digital content" to avoid state and local taxation of such content because it is delivered over the Internet. Additionally, states and local governments usually have some form of telecommunications taxes that are applied to services like voice communications, e.g. landline phones.

The 2004 extension of ITFA broadened its moratorium by barring state and local taxation of most telecommunications services involved in obtaining or providing Internet access, including high-speed Digital Subscriber Line or "DSL" telephone lines. Further, if a phone line is used to also deliver Internet (e.g. DSL) and the customer's bill does not differentiate between the phone and Internet portions, it is considered a "bundle" and states and local governments will

not be able to tax the entire bundle. In contrast, the 2007 extension clarified that state and local governments would be free to tax Voice over Internet Protocol (VOIP) and similar services.

The ITFA prohibition also impacts franchise fees, an important revenue source for many counties. Currently, local governments are entitled to collect up to five percent of a cable operator's gross revenue as a franchise fee. Franchise fees can be thought of as a rental fee for use of public rights of way. Franchise fees cannot be assessed on Internet services; this poses a problem for counties as more services move toward a broadband-delivery model. For example, Internet-protocol television (IPTV) looks like traditional cable television but is delivered over the Internet. As a result of the delivery method, IPTV is exempt from taxation and is also exempt from being calculated into a cable operator's gross revenue from which counties derive franchise fees.

KEY TALKING POINTS:

- The original intent of ITFA in 1998 was to encourage development of the Internet, which at the time was a new technology. This justification is no longer applicable given the substantial advancements in technology that have occurred since 1998.

- Bundling non-Internet based services with Internet services creates a loophole for industry to avoid taxes altogether.

- If ITFA is extended, it should change the definition of "Internet access" to ensure that digital goods and online services that do not constitute true Internet access – i.e. connection to the Internet – are not tax-exempt.

- The Pew Internet Project surveyed adults who do not use the Internet. Among this population, more than half state that the main reason they do not go online is because they do not think that the Internet is relevant to them or that it is not very easy to use, rather than the cost as proponents of the ITFA claim.

- Permanently extending ITFA would distort the federal-state-local relationship as it is a federal preemption of state and local taxing authority. Preemptions like ITFA should not be permanent; rather, it should be periodically revisited, as Congress originally intended, to determine whether the circumstances creating the need still exist.

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