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Read My Bits: No New Taxes (Permanently)

James L. Gattuso

At midnight on October 31, Congress's longstanding moratorium on state Internet taxation expires, freeing state and local governments to tax online access and other Web services enjoyed by Americans. The ban has been up for renewal four times in the past 16 years, raising constant concern that this protection from taxation will not be continued. This time, Congress should make the moratorium a permanent ban, as the Permanent Internet Tax Freedom Act (H.R. 3086) would do.

Background

The moratorium on state Internet taxation was first imposed in 1998, when Congress adopted a three-year moratorium on state and local taxation of Internet services. The moratorium, with some modifications, has been extended three times since then, most recently in 2007.[1]

Specifically, the ban prohibits states from imposing taxes on "Internet access" as well as any "multiple or discriminatory" taxes on electronic commerce.[2] This protects Americans from direct surcharges by states on their Internet service from whatever source—such as cable modems, wireless connections, or digital subscriber lines (DSL) from their phone company. It also blocks states from collecting taxes on specific Internet services such as e-mails or instant messages, or "bit" taxes based on Internet usage.

This Internet tax ban does not cover imposition of sales taxes on Internet transactions, which is an entirely separate debate. That issue involves the power of state tax collectors to require out-of-state retailers to collect sales taxes for them. While not prohibited by Congress's Internet tax moratorium, such mandates have been properly limited by the courts.[3]

A Welcome Step

On June 18, the House Judiciary Committee approved H.R. 3086 to make the Internet tax ban permanent. It would also extend the ban to state taxes imposed before 1998, which had previously been allowed under a "grandfather" clause.

Since the first moratorium was adopted in 1998, the Internet has expanded dramatically, growing from a promising new technology to an integral part of the U.S. economy and American society. But to continue this success, state and local tax collectors must not be allowed to target the Internet to fill their coffers. By making the ban permanent, the House bill also provides some certainty to the entrepreneurs and others who want to invest in this technology that new taxes will not derail their efforts.

The Need for Permanence

The investment at stake is far from trivial: Of the 25 firms investing the most in the U.S. economy, 11 are in Internet-related businesses—including the two largest, AT&T and Verizon, who invested nearly $35 billion in 2013.[4] This is one of the few parts of

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The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

the economy booming today. Policymakers should ensure that this success is not threatened by the prospect of taxation.

One particular concern is the effect taxation could have on subscribership to broadband Internet services. While the number of Americans subscribing to such services has been growing rapidly, taxes on access could slow that growth—especially among low-income consumers. The subscribership loss could be significant. According to a study by economist George Ford of the Phoenix Center, even a relatively low average tax of 2.5 percent could reduce broadband subscribership by five million to 15 million, compared to what it would otherwise be. If state taxes average 5 percent, the loss could total 10 million to a whopping 30 million subscribers.[5]

Some have argued that despite the economic dangers, a federal ban on state Internet taxation would violate state prerogatives. The tax ban, however, is fully consistent with the principles of federalism. The Internet, by its nature, is an interstate network. The effects of Internet tax policy in one state are borne not just by that state's citizens, but by citizens of other states.

A tax on Internet service can be a tempting way for a state to raise money from out-of-state tech firms, rather than from their own constituents. But the interstate effects go beyond such cost shifting. Even a tax that affects in-state residents and out-of-state residents equally can, by slowing Internet growth as a whole, hurt consumers in other states.

H.R. 3086 now goes to the House floor. The most difficult hurdle, though, will be the Senate. In addition to opposition to the bill itself, there is much talk in the Senate of adding on a proposal to expand state sales tax authority over Internet sales. That would not only be bad policy, but would unnecessarily jeopardize the broader tax ban.

The federal restriction on taxes on the Internet has proven sensible and successful. Rather than let it expire, policymakers should make it permanent.

*—**James L. Gattuso** is Senior Research Fellow for Regulatory Policy in the Thomas A. Roe Institute for Economic Policy Studies, of the Institute for Economic Freedom and Opportunity, at The Heritage Foundation.*

1. See James L. Gattuso, "A Scare for the Web: Will Congress Let the Internet Tax Ban Expire?" Heritage Foundation *WebMemo* No. 1673, October 22, 2007, http://www.heritage.org/research/reports/2007/10/a-scare-for-the-web-will-congress-let-the-internet-tax-ban-expire.
2. 47 U.S.C. 151.
3. See James L. Gattuso, "Taxing Online Sales: Should the Taxman's Grasp Exceed His Reach?" Heritage Foundation *Backgrounder* No. 2817, June 19, 2013, http://www.heritage.org/research/reports/2013/06/taxing-online-sales-should-the-taxmans-grasp-exceed-his-reach.
4. Diana G. Carew and Michael Mandel, "U.S. Investment Heroes of 2013: The Companies Betting on America's Future," Progressive Policy Institute, September 2013, http://www.progressivepolicy.org/wp-content/uploads/2013/09/2013.09-Carew-Mandel_US-Investment-Heroes-of-2013.pdf (accessed June 27, 2014).
5. George S. Ford, "Should the Internet Tax Moratorium Be Made Permanent?" Phoenix Center *Policy Perspective* No. 14-03, June 2, 2014, http://www.phoenix-center.org/perspectives/Perspective14-03Final.pdf (accessed June 27, 2014).