Internet Tax Simplification: Is It Really That Simple?

Faced with budget shortfalls that will exceed $100 billion over the next 12-18 months – including $39 billion in California, $11 billion in New York and $4 billion in Texas – state and municipal revenue agencies are again turning their attention to taxation of the Internet.

Even as this caucus meets, the Colorado Internet Cooperative – a non-profit organization serving ISPs in hundreds of Colorado communities and locations – is being asked to pay $170,644.35 in "back taxes." The demand and the tax it represents -- a new and special "bandwidth" tax not demanded of any other companies in Boulder -- are a violation of federal law. The city of Boulder says it will drop the tax demand if the Coop agrees to voluntarily submit to such taxes in the future, enabling the city to sidestep the law. (See Denver Post article on this issue at http://www.denverpost.com/Stories/0,1413,36~53~1417123,00.html)

The US Internet Industry Association opposes multiple, discriminatory taxes as well as taxes on Internet access. That is why we assisted in authoring and securing passage of the Internet Tax Freedom Act of 1998, the extension of that act in 2001, and immediate passage of the Internet Tax Non-Discrimination Act of 2003. The Association notes that:

- Internet services and their subscribers are already taxed at the state and local levels, through telecommunications taxes, business taxes, personal property taxes, payroll taxes and other taxes.
- Taxation of Internet access will serve only to slow the adoption of Internet services, particularly broadband. This will, in turn, have negative consequences on our national goal of ubiquitous broadband services to all segments of America. It will also forestall a financial recovery in the fall of 2003, with further disastrous results for the industry, for consumers and for communities across the nation.
- Even if states and communities were able to tax Internet access, the revenue raised would fall far short of what any state needs to meet its budget crisis. There are, as of April of 2003, 97 million households in America that are connected to the Internet. Of these, 16.6 million use cable Internet connections; 9.12 million use DSL connections; 324,000 use fixed wireless or satellite connections; and 71 million households use dial-up connections. These connections generate an estimated $34.8 billion in annual revenue, based on broadband connections at $45 per month and dial-up access at $18 per month. Taxing this even at 10 percent would not yield any state enough to make a noticeable dent in its budget shortfall.

The USIIA does not oppose the application of taxes to Internet transactions, so long as such taxes are fair and non-discriminatory, and so long as such application meets the requirements set forth in the 1992 Supreme Court decision in Quill v. North Dakota. To date, the states have neither met that requirement nor presented any substantive plan to do so.

It may also be noted that, similar to the situation with taxation of Internet access, taxation of transactions will cause irreparable harm to small businesses and the Internet while providing no meaningful relief to states and municipalities. Jupiter Research projects that retail sales over the Internet will reach $51.7 billion in 2003. If taxes at an average sales tax rate of 7 percent, this would generate only an estimated $3.6 billion this year.

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