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THE ALEXANDER-CARPER INTERNET ACCESS TAX MORATORIUM BILL, S. 2084: A TRUE COMPROMISE THAT SUBSTANTIALLY BROADENS THE ORIGINAL MORATORIUM

By Michael Mazerov

Summary

Senators Lamar Alexander and Thomas Carper, with nine original cosponsors, have introduced S. 2084, the "Internet Tax Ban Extension and Improvement Act." This bill would reinstate and broaden the "moratorium" on state and local taxation of Internet access services originally imposed in 1998 by the Internet Tax Freedom Act (ITFA). S. 2084 would bar state and local governments for two more years from taxing the typical $10-$50 monthly charge that households and businesses pay — to an Internet access provider like America Online, or to the local phone or cable TV company — to be able to access the World Wide Web and send and receive e-mail.

- S. 2084 would broaden the original ITFA moratorium substantially by newly exempting from taxation all telecommunications services "purchased, used, or sold by an Internet access provider to connect a purchaser of Internet access to the Internet access provider."

- This new language in S. 2084, which amends ITFA's definition of Internet access, exempts from new state and local taxes almost all communications services that an Internet access subscriber can use to connect to her Internet access provider — so-called "last mile" telecommunications. S. 2084 would, however, grandfather *existing* state and local taxes on "last-mile" telecommunications services. Grandfathering currently-collected taxes is consistent with the sponsors' position that Congress should not impose a new, expensive, "unfunded mandate" on state and local governments, especially at a time of severe fiscal stress.

- The new language to be added to ITFA's Internet access definition by S. 2084 seeks to achieve "technological neutrality" in the tax treatment of high-speed access by exempting from tax all the forms in which the "last mile" connection is made: cable modems, "Digital Subscriber Lines" (DSL), dedicated "T-1" lines used by businesses, wireless connections (e.g., Blackberry), and satellite transmissions. The only exception to the tax exemption for "last mile" telecommunications would be ordinary voice telephone lines used for "dial-up"

(conventional modem) access to the Internet; taxes on such lines would still be allowed under S. 2084.

- S. 2084 is a significant expansion of the moratorium. As enacted in 1998 (and as renewed in 2001), the Internet Tax Freedom Act had excluded (carved out) from the definition of tax-exempt "Internet access" *all* telecommunications services — as that term is defined by the Federal Communications Commission. Thus all states and localities were allowed to continue taxing all telecommunications services, even those used to obtain or provide Internet access on the "last mile."

- The authorization of state and local governments to continue taxing telecommunications was consciously and intentionally included in ITFA in order to preserve state and local taxes and fees imposed on all forms of telecommunications services used at any point along the Internet. While some have claimed that S. 2084's grandfather provision condones "illegal" taxes on Internet-related telecommunications imposed by states and localities attempting an "end run" around ITFA, the legislative history of ITFA clearly refutes those claims.

- Renewing ITFA in its original form would preserve state and local taxes on all Internet-related telecommunications. The proposed S. 150 would prohibit all state and local taxation of both "last mile" telecommunications services and the "upstream" telecommunications services that constitute the underlying infrastructure and "backbone" of the Internet. (According to the Federation of Tax Administrators, states and localities would lose approximately $500 million annually if "upstream" telecommunications services were no longer taxable.) In prohibiting new taxes on "last mile" telecommunications, S. 2084 represents a true compromise between these two alternatives.

State and Local Taxation of Internet-Related Telecommunications: A Central Point of Conflict in the Current Debate over Renewing the Internet Access Tax Moratorium

The primary objective of the Internet Tax Freedom Act was to bar new state and local taxes on monthly subscriber charges for basic Internet access service — the ability to send and receive e-mail and to access the World Wide Web. As enacted in 1998, ITFA defined tax-exempt "Internet access" as follows:

> 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 provided to consumers. *Such term does not include telecommunications services*. [Emphasis added.]

Elsewhere, ITFA defined the excluded or carved-out "telecommunications services" as having "the meaning given such term in . . . the Communications Act of 1934 . . . and include[ing] telecommunications services (as defined in section 4251 of the Internal Revenue Code of 1986)." Effectively, this definition means that any telecommunications service that *either* satisfies the definition of "telecommunications service" under the Communications Act — including final interpretations of that definition made by courts — *or* is subject to the federal telecommunications excise tax, may continue to be taxed by state and local governments under ITFA.

ITFA was scheduled to (and eventually did) expire on October 31, 2003.[1] H.R. 49 and S. 150 were introduced last year to extend the moratorium permanently. In addition, both bills proposed to narrow the ITFA carve-out for telecommunications services and thereby *encompass* virtually all Internet-related telecommunications services within the definition of tax-exempt "Internet access."[2] Both the proposed permanent extension and the proposed change in the telecommunications provision generated enormous opposition to the renewal of the moratorium from state and local government officials. Although H.R. 49 passed the House, state and local government opposition has prevented action on S. 150. Senators Lamar Alexander and Thomas Carper, with the support of the National Governors' Association and other state and local organizations, recently introduced S. 2084 as an alternative to S. 150/H.R. 49. S. 2084 would also sweep some Internet-related telecommunications services into the definition of tax-exempt Internet access, but S. 2084 would not be nearly as damaging to state and local finances as S. 150/H.R. 49 would be.

The Treatment of Internet-related Telecommunications Services in S. 150/H.R. 49

S. 150 (as modified by a proposed "managers' amendment") would define tax-exempt "Internet access" as follows:

> 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 provided to consumers. 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*. [Emphasis added.][3]

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[1] ITFA had been enacted in 1998 for three years. It had been renewed for two additional years in 2001.

[2] See the following note for a discussion of the taxability under S. 150/H.R. 49 of ordinary voice telephone lines used for Internet access.

[3] H.R. 49 substitutes for the italicized language the clause "except to the extent such services are used to provide Internet access." According to the sponsors of both bills, there is no difference in the goal of this provision despite the slight difference in wording. The stated goal is to ban all state and local taxation of telecommunications services used anywhere along the Internet except for ordinary voice telephone lines used for dial-up access. The rewording of S. 150's telecommunications provision by the managers' amendment was intended to address state and local concerns that the language in H.R. 49 did not adequately protect taxation of voice telephone service; whether S. 150's language is superior to H.R. 49's in this respect is debatable but not central to the argument of this paper.

The goal of the italicized language is to encompass within the definition of tax-exempt "Internet access" nearly all telecommunications services used to obtain or provide Internet access anywhere along the Internet. Such telecommunications services can be thought of as falling into three segments: the "last mile," the "middle mile," and the Internet "backbone."

- "Last mile" telecommunications services are those used to connect an Internet access customer or subscriber to her Internet access provider. The customers may be households or businesses, and the providers may be specialized Internet Service Providers (ISPs) like America Online or Earthlink or telecommunications or cable TV companies like MCI, Verizon, or Comcast. The "last mile" telecommunications technologies in use include ordinary voice telephone lines (used with a conventional modem in so-called "dial-up" service); high-speed "Digital Subscriber Lines" (DSL); coaxial TV cable (used with "cable modems"); dedicated, high-speed "T-1" lines leased by businesses; wireless linkages (such as those used by Blackberry handheld devices, Internet-equipped cell phones, and "Wi-Fi"-equipped laptop computers"); and satellite linkages (such as Direcway from Hughes Network Systems).

- "Middle mile" telecommunications services are those services that constitute the basic network infrastructure of the Internet Service Providers. An example of such services would be the high-speed lines that a national ISP like America Online leases from a telecommunications network provider like Sprint or Level 3 to connect its local "points of presence" in every city with its mainframe computers in Virginia.

- The Internet "backbone" refers to the very high-speed, very high-capacity, fiber-optic trunk lines that crisscross the United States — and, indeed, the world — and connect the networks of major Internet service providers like America Online and Earthlink to each other. UUNet and Sprint are examples of major Internet backbone providers.

H.R. 49 and S. 150 are intended to and would prohibit state and local taxation of all three categories of Internet-related telecommunications services — the "last mile," the "middle mile," and the "backbone."[4] The prohibited taxes generally are sales taxes and gross receipts taxes on the gross sales of the companies providing these services. H.R. 49 would ban all such taxes immediately upon enactment. S. 150 would "grandfather" existing state and local taxes on all three categories of Internet-related telecommunications services for three years — provided that state and local governments could demonstrate that the taxes were being actively enforced when ITFA first went into effect in 1998.

[4] Both bills would also effectively prohibit taxation of another category of Internet-related telecommunications: so-called "voice over Internet protocol" or VoIP telephone services. Many VoIP services use the Internet to make some or all voice telephone calls. The impact of S. 150/H.R. 49 on the taxability of VoIP services is beyond the scope of this report. It is the subject of another Center on Budget and Policy Priorities paper. See: Michael Mazerov, *A Permanent Ban on Internet Access Taxation Risks Serious Erosion of State and Local Telephone Tax Revenue as Voice Calls Migrate to the Internet*, February 19, 2004. Available at www.cbpp.org/2-11-04sfp.pdf.

The primary impetus for the proposed expansion of ITFA to encompass Internet-related telecommunications services was a desire to reestablish a "level playing field" in the state and local tax treatment of two competing forms of high-speed Internet access service widely purchased by households — cable modem Internet access and "Digital Subscriber Line" Internet access.[5] Due to the regulatory treatment of cable modem Internet access by the FCC, ITFA effectively prohibited states and localities from taxing any part of the monthly charge for such access.[6] However, because the FCC deems DSL to be a "telecommunications service," states and localities can, consistent with ITFA, require a DSL Internet access provider to split the monthly charge into a taxable amount for the DSL phone line and a tax-exempt amount for Internet access. Approximately half the states are taxing DSL under this authority.

The unequal tax treatment of DSL and cable modem access — which are locked in fierce competition in the marketplace — was of understandable concern to the telecommunications companies selling DSL. Taking advantage of the fact that ITFA was up for renewal, these companies pushed the sponsors of H.R. 49 and S. 150 to amend the telecommunications "carve out" in the definition of Internet access to ensure that the entire monthly charge for DSL-based Internet access also would be completely exempt from state and local taxation. Both bills were amended in committee to achieve this objective.

Of course, both bills went much further than was necessary to achieve a level playing field in the state and local tax treatment of cable modem and DSL access. First, S. 150/H.R. 49 exempt *all* forms of "last mile" telecommunications services from state and local taxation, even those that arguably are not in competition with DSL/cable — either because they are many times more expensive (e.g., the T-1 lines leased by businesses) or because they are likely to be purchased in addition to DSL/cable rather than as a substitute (e.g., Blackberry or cell phone Internet access.) Second, in addition to exempting from taxation "last mile" telecommunications, S. 150/H.R. 49 exempts as well what might collectively be termed the "upstream" telecommunications services — that is, the "middle mile" and the Internet backbone.

The Treatment of Internet-related Telecommunications Services in S. 2084

State and local government organizations opposed the efforts of the proponents of S. 150/H.R. 49 to make the Internet access tax moratorium permanent and to solve the narrow problem of non-neutral tax treatment of DSL and cable modem Internet access by prohibiting the taxation of all Internet-related telecommunications. A number of Senators, led by Lamar Alexander and Thomas Carper, shared these state and local concerns. As the time for floor action on S. 150 approached, they circulated an amendment to the bill that proposed to renew

[5] Cable modem Internet access is provided by cable TV companies over their neighborhood coaxial cable networks. DSL is provided by the four regional "Baby Bell" telephone companies and some independent telecommunications companies that lease access to the Bells' phone lines. DSL uses ordinary phone lines to provide high-speed Internet access and is widely purchased by both households and businesses. Cable modem access is purchased primarily by residences, although of course a home-based business could subscribe to cable modem access as well.

[6] The DSL vs. cable modem issue is discussed at greater length in Michael Mazerov, *Making the Internet Tax Freedom Act Permanent in the Form Currently Proposed Would Lead to a Substantial Revenue Loss for States and Localities*, Center on Budget and Policy Priorities, October 20, 2004, pp. 8-12. Available at www.cbpp.org/10-20-03sfp.pdf.

ITFA for only two years and to address the non-neutral tax treatment of DSL and cable access in a way less damaging to state and local revenues. They were prepared to offer the amendment on November 6, 2003, when S. 150 was brought to the floor for debate and action. However, following several hours of debate, leadership pulled the bill from the floor.

On February 12, 2004, Senators Alexander and Carper and nine initial cosponsors introduced S. 2084, the "Internet Tax Ban Extension and Improvement Act." The bill incorporates the provisions of the previously-proposed Alexander-Carper amendment to S. 150, as well as some provisions of the proposed "managers' amendment" to S. 150 that they support. S. 2084 proposes to reword the definition of Internet access as indicated in the italicized text below:

> 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 provided to consumers. *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."* [Emphasis added.]

This language is intended to exempt from new state and local taxes all "last mile" telecommunications services used to obtain Internet access. Like S. 150/H.R. 49, S. 2084 is intended to encompass in the definition of Internet access all forms in which that connection is made except for an ordinary voice telephone line used for dial-up access.[7] Unlike S. 150/H.R. 49, however, that language does *not* encompass within tax-exempt Internet access *any* of the "upstream" telecommunications services purchased by ISPs or Internet backbone providers.

Another key difference between S. 2084 and S. 150/H.R. 49 with respect to the taxation of Internet-related telecommunications services is that S. 2084 grandfathers existing state and local taxes on all "last-mile" telecommunications services if those taxes had been in force by November 1, 2003.[8] Consistent with the sponsors' strong opposition to imposing new "unfunded mandates" on state and local government — particularly at a time of severe fiscal stress — this grandfather provision would preserve existing taxes on DSL service collected by approximately half the states.[9] In contrast, H.R. 49 would eliminate all grandfathering of these taxes, and S.

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[7] The language arguably does not encompass an ordinary voice telephone line because such a line is not "sold. . . to connect a purchaser of Internet access to the Internet access provider" but rather to provide general voice telephone service that only secondarily is used to obtain Internet access.

[8] A third key difference between S. 150/H.R. 49 and S. 2084 with respect to their treatment of Internet-related telecommunications is that only S. 150/H.R. 49 would immediately prohibit the taxation of "voice over Internet protocol" telephone services. See the source cited in footnote 4.

[9] The Unfunded Mandates Reform Act of 1995 treats federal preemption of existing state and local taxes as an "unfunded mandate" subject to a budget point of order just as direct spending mandates are. Such a classification seems particularly appropriate in the context of current proposals to make ITFA permanent, which are being explicitly justified as a means of encouraging consumer demand for high-speed Internet access by making it less expensive than it might otherwise be. If the federal government enacted a law requiring state and local governments to pay — without federal reimbursement — a direct cash subsidy to Internet access providers of a dollar or two per

150 would only grandfather taxes on "last-mile" telecommunications that were in force in 1998. Since DSL was not widely available at that time, it is likely that most telecommunications companies would stop collecting taxes on DSL service even if S. 150 rather than H.R. 49 were enacted.

In sum, S. 2084 *broadens* the moratorium on state and local taxation of Internet access first imposed by ITFA by prohibiting new taxes on all "last mile" telecommunications services used to obtain Internet access. It is less far-reaching than H.R. 49 and S. 150 in that it

- grandfathers all taxes on "last-mile" telecommunications that are currently being collected;
- preserves existing state and local taxes imposed on telecommunications companies providing "upstream" — "middle mile" and Internet "backbone" — services to Internet access providers; and
- extends ITFA for only two years rather than permanently.

Attacks on S. 2084 by the Proponents of S. 150 Are Based on False Claims about ITFA's Legislative History

Although S. 2084 would block *new* state and local taxes on "last mile" telecommunications services immediately upon enactment, it would grandfather *existing* taxes on these connections for the two years for which the moratorium would be extended. In a "Dear Colleague" letter dated February 24, 2004 and titled "Don't Be Fooled by New Internet Tax Bill," Senators Allen and Wyden and other proponents of S. 150 label such grandfathering a preservation of "illegal taxes." They assert that S. 2084's broadening of the moratorium to block all new state and local taxes on "last mile" connections to the Internet is no concession at all, but merely the preservation of the original intent of Congress in 1998.

The Plain Wording of ITFA Allows Taxation of Internet-related Telecommunications

The claim that S. 2084 is not a true compromise because Congress always intended to exempt Internet-related telecommunications services from state and local taxation is false:

- As discussed above, the plain wording of ITFA excluded *all* "telecommunications services" from the definition of tax exempt "Internet access." Again, ITFA defined tax-exempt Internet access service as follows:

  > 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,

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month in the hope that the providers would hold their monthly fees down, few people would dispute that such a law would be imposing an unfunded mandate on these governments. A law with the same objective achieved by prohibiting the collection of otherwise legal taxes is no less of an unfunded mandate.

and other services as part of a package of services provided to consumers. *Such term does not include telecommunications services*. [Emphasis added.]

- Again, ITFA defined "telecommunications services" as having "the meaning given such term in . . . the Communications Act of 1934. . ." Obviously, there are *no* limitations or restrictions in the wording of ITFA itself that would suggest that Congress intended the authority to continue to tax telecommunications to apply to only certain types of services.

ITFA's Legislative History Reveals Congressional Intent to Preserve Telecom Taxes

In addition to the plain wording of ITFA, substantial legislative history demonstrates that the preservation of all taxes on telecommunications services, even those used to provide Internet access, was the clear, self-conscious intent of Congress at the time of ITFA's enactment:

- The May 5, 1998, Senate Commerce Committee report on ITFA states that the bill: "preserves taxes imposed on a provider of telecommunications services to ensure that State and local telecommunications taxes, fees, and regulations are unaffected by the bill. The preservation of this taxing authority, *added to the original version of the bill*, is intended to apply to entities when they act as telecommunications service providers and not as Internet access or online service providers. For example, *a company that provides both telecommunications and Internet access service and uses its lines to provide Internet access does not cause such lines to be exempt from telecommunications taxes.* [Emphasis added.] Translated to the current debate, the last sentence implies that when Verizon "uses its [Digital Subscriber] lines to provide Internet access[, Verizon] does not cause such lines to be exempt from telecommunications taxes."

- Senators Allen and Wyden and the other opponents of S. 2084 object most stridently to its grandfathering of taxes imposed on Digital Subscriber Lines (DSL) by approximately half the states. Yet at the time the moratorium was enacted in 1998, the FCC had already declared that DSL was a telecommunications service separate and distinct from "Internet access." In a report issued two months before ITFA was enacted, the FCC observed "An end-user may utilize a telecommunications service together with an information service, as in the case of Internet access. In such case, however, we treat the two services separately: the first service is a telecommunications service (*e.g., the xDSL transmission path*), and the second service is an information service, in this case Internet access." [Emphasis added.]

- DSL was not widely available at the time ITFA was enacted. However, a precursor technology to DSL, "Integrated Services Digital Network" (ISDN), was widely used to obtain high-speed Internet access over copper phone lines (just as DSL is now). According to the FCC, there were over 1.5 million ISDN lines in service at the end of 1998. Dedicated, high speed "T-1" lines were also widely

used by larger corporations to obtain access to the Internet at that time. If Congress had intended to block the taxation of such high-speed telecommunications services used by businesses to obtain Internet access in 1998, it surely could have done so. No one argued that it ought to, and it did not.

Congress and Industry Intended to Preserve Taxation of "Upstream" Telecom

In their February 24 "Dear Colleague" letter, Senators Allen and Wyden also object to the fact that S. 2084 — unlike S. 150/H.R. 49 — would only ban state and local taxes on "last-mile" telecommunications services. Here again, however, the preservation of existing state and local taxes on "upstream" telecommunications services appears to have been the clear intent of Congress and the business proponents of ITFA at the time the law was enacted:

- The plain wording of ITFA excluded all telecommunications services from the definition of tax-exempt Internet access, not just telecommunications services used on the "last mile" to the subscriber. The Senate Commerce Committee report cited above drew no distinctions between the taxability under ITFA of "last mile" and "upstream" telecommunications services.

- Far from seeking or anticipating a tax exemption for the telecommunications services it purchased to assemble its network or connect to the Internet backbone, the largest Internet access provider in the United States, America Online, used the *existence* of state and local taxes on such services as a *justification* for exempting "end-user" Internet access service from taxation. It argued that taxing access would constitute double taxation. It did *not* argue at that time that both access and telecommunications should be exempt from taxation:

> Senator Chafee (at a July 16, 1998 Senate Finance Committee hearing): "I am just not quite sure why you are here, why we are all here, to tell you the truth. I do not see why the suggestion is that you should not be taxed and yet telephone taxes are perfectly all right. Every state imposes telephone taxes. . . . As does the Federal Government. . . ."
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> Jill Lesser, Director, Law and Public Policy, America Online: "[W]ith respect to your question about telecommunication taxes, I think it is important [to] note that . . . most if not all of America Online's access is done through telephone lines. And so telephone lines are either leased or purchased. . . from two ends, both at the consumer end for a line to get online *and at America Online's end. Our telecommunications charges total over $1 billion per year. And we pay taxes on all of those charges. . . So in terms of accessing the Internet. . . we do pay taxes over the use of telecommunications when we use them as users.* And we believe that with the current system, particularly when some States are also calling us telecommunication services, that it would result at this point in double taxation." [Emphasis added.]

- An analysis of an interim draft of ITFA by the Committee on State Taxation (an organization representing major multistate corporations, which supported ITFA) gave an example of the effect of the language preserving state and local telecommunications taxes and fees that explicitly cited backbone services as remaining taxable: "For example, ABC Co. provides both telecommunications and Internet access services. *The fact that ABC Co. may use its lines as a backbone to provide Internet access does not cause such lines to be exempt* from telecommunications 'right of way' franchise fees." [Emphasis added.].

Telecom Industry Didn't Propose Abolition of Taxes When It Had Forum to Do So

Finally, it should be noted that until this year the telecommunications industry had never argued that Internet-related telecommunications services should be completely exempt from state and local taxes. ITFA created an "Advisory Commission on Electronic Commerce" (ACEC) headed by former Virginia Governor James Gilmore. ACEC examined appropriate long-term federal policy with respect to state and local taxation of both Internet access services and telecommunications. In November 1999, a coalition of 12 major telecommunications companies submitted to ACEC "A Proposal for State and Local Taxation of the Telecommunications Industry." This statement does not advocate in any way that either "upstream" telecommunications services or "last mile" telecommunications services purchased by end-users to access the Internet be exempted from state and local taxes. Moreover, when ACEC issued its final report in April 2000, a majority of its members recommended a rationalization of state and local telecommunications taxes along the lines that had been suggested by the industry in its submission. However, the ACEC majority did not in any way recommend a blanket exemption of Internet-related telecommunications services from state and local taxation.

In short, state and local governments that have been taxing telecommunications services used to provide Internet access — both "last mile" telecommunications services purchased by subscribers and "upstream" telecommunications services" purchased by access providers — have been entirely within their rights to do so under the clear wording and intent of Congress in crafting the Internet Tax Freedom Act. Accordingly, the support of state and local government organizations for S. 2084, which would ban all new state and local taxes on all "last mile" connections, is a substantial concession and compromise. Rather than "narrowing the definition of Internet access" as claimed by Senators Allen and Wyden in their "Dear Colleague," that provision of S. 2084 represents a substantial *broadening* of the original moratorium.

An Unsupported and Illogical Argument for Prohibiting Taxation of "Upstream" Telecommunications

As discussed above, both S. 2084 and S. 150/H.R. 49 would bar all new state and local taxes on "last mile" telecommunications services used by an Internet access subscriber to connect to her access provider. S. 150/H.R. 49 goes further, however, and also would bar taxes on all telecommunications services used "upstream" of the Internet access provider, anywhere along the Internet. For example, taxes on high-speed fiber-optic lines leased by Internet service

providers to connect their networks to the main Internet "backbones" would be barred by S. 150/H.R. 49.

The principal argument offered by Senators Allen and Wyden as to why these "upstream" telecommunication services should also be tax exempt is that if state and local governments are barred from taxing Internet access and "last mile" telecommunications only, they will seek to obtain the same amount of revenue from Internet access subscribers by raising taxes on the upstream services. In their February 24, 2004, "Dear Colleague," they assert that S. 2084 would:

> Authorize new taxes by narrowing the definition of Internet Access to cover only the connection between purchaser [sic] of Internet access and the Internet service provider. Tax collectors will merely push the taxes up the network line and consumers will pay these taxes in one form or another. States and localities are permitted to impose new Internet taxes with no political accountability.

As described above, it is a mischaracterization to say that S. 2084 "narrow[s] the definition" of Internet access. Beyond that, the argument that states and localities will pile taxes on "upstream" telecommunications services is both unsupported by evidence and illogical:

- Despite suffering through the worst government fiscal crisis in more than 50 years, state and local governments have enacted very few increases in telecommunications taxes. All but eleven states have been barred from taxing Internet access throughout this crisis. According to annual surveys by the National Conference of State Legislatures, however, only five states increased telecommunications taxes since the recession began in 2001. None of the increases targeted "upstream" telecommunications.

- Senators Allen and Wyden assert that if taxes on "upstream" services are not also barred, "States and localities [would be] permitted to impose new Internet taxes with no political accountability." They claim that "Tax collectors will merely push the taxes up the network line and consumers will pay these taxes in one form or another." It is difficult to see how both of these statements can be true. Consumers are voters and are capable of holding their elected officials accountable for tax increases they find unacceptable. Senators Allen and Wyden present no evidence to support their contention that in the absence of congressionally-imposed limits, state and local officials could impose taxes on their constituents at will.

- It might be argued that "upstream" taxes will be imposed on the telecommunications providers and thereby be hidden from the consumers who could otherwise ensure that such taxes would be repealed or not enacted in the first place. The argument is contradicted by numerous examples of telecommunications companies and other utilities alerting their customers about potential or actual increases in their rates resulting from federal, state, and local tax and fee increases (such as the "federal subscriber line charge" imposed several years ago). Indeed, many of the taxes on DSL service that Senators Allen and

Wyden most object to are gross receipts taxes that are imposed on the providers but that the providers chose to place on customer bills to alert customers to their existence.[10] If state and local government officials did seek to "push" barred taxes "up the network line," the telecommunications companies would have every interest in informing consumers of the tax increases under consideration.

- In any case, the Allen-Wyden argument leads to an obviously unacceptable policy: Congress must preempt *all* state and local taxes on telecommunications companies. By their logic, if state and local governments are barred by S. 150 from taxing all telecommunications services used to provide Internet access, they will only respond by increasing taxes on the property, profits, payrolls, and/or purchases of these companies. For example, if states cannot tax private lines leased to Internet access providers by telecommunications companies, what is to stop states from taxing the initial purchase of fiber optic cable by the telecommunications company at a rate sufficient to raise an equivalent amount of revenue? In short, the justification for broadening ITFA to encompass all "upstream" telecommunications services comprising the infrastructure of the Internet leads logically to far-reaching and unacceptable interference by Congress in state and local taxation.

- It is ironic that Senators Allen and Wyden justify prohibiting taxes on "upstream" telecommunications on the grounds that state and local officials are "unaccountable" for such taxes. The real unaccountability lies in S. 150/H.R. 49 itself, which would permanently prohibit all taxation of Internet access and Internet-related telecommunications. If state and local governments are prohibited from raising revenue in this way, either some state and local services that would otherwise be provided will be curtailed, or someone else's taxes will be higher to make up the forgone revenue. It is state and local officials — not members of Congress — who will be held accountable for such outcomes. The imbalance between the enacting body (Congress) and the accountable entities (state and local governments) is the reason Congress included within the Unfunded Mandates Reform Act of 1995 any legislation that seeks to preempt state and local taxing powers. Congress sought to tie its own hands to avoid the temptation to achieve federal policy objectives by giving away the tax revenues of states and localities with little if any accountability to the affected local citizens.

In the course of the debate on S. 150, Senator Allen has several times referred to state tax "commissars" who oppose the legislation. While such a reference may resonate with some supporters of S. 150, the United States is not an undemocratic nation like the former Soviet Union. State and local officials do have constituents to answer to and are constrained in their ability to increase taxes on telecommunications companies that would be passed through to these consumers/voters. The stated case of Senators Allen and Wyden for exempting telecommunications services all up and down the Internet is founded on an inaccurate and disingenuous characterization of the political reality confronting state and local elected officials.

[10] See: Jim Hu, "Earthlink Yields to Net Taxes," C/net News.com, June 3, 2003.

Conclusion

Access to the Internet — including high-speed, "broadband" access —boomed under the Internet Tax Freedom Act as it existed from November 1998 through October 2003. The enactment of S. 2084 would extend the ITFA moratorium even further and block all new state and local taxes on "last mile" telecommunications services used to connect an Internet access subscriber to her Internet access provider. S. 2084 represents a viable compromise on this issue and a substantial concession on the part of state and local government organizations. A compelling justification for going further has yet to be offered.