



Research

# The Cost of an Internet Access Tax

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## INTRODUCTION

A ban on Internet access taxes has sailed through the House and is awaiting Senate action before the end of session. The Permanent Internet Tax Freedom Act is a permanent extension of the Internet Tax Freedom Act (ITFA), which was passed in 1998 to prevent local and state governments from taxing consumers for Internet access or levying Internet-specific taxes. By our estimates, letting the Internet Tax Freedom Act sunset could cost consumers \$14.7 billion a year in taxes if Internet access were subject to the countless taxes of wireless service. With businesses and families already feeling the brunt of the high taxes and a slow recovery, a new tax could hurt this dynamic part of the economy.

With a sunset of ITFA coming in mid-December, some have tried to rope this must-pass bill with the more contentious issue of Internet sales tax. However, taxation of Internet access should be judged on its own merits, separate from the broader issue of taxation on goods sold over the Internet.

## BROADBAND ADOPTION

Since its original passage in 1998, ITFA has been reauthorized with some minor changes in 2001, 2004 and 2007.<sup>[1]</sup> The Continuing Resolution passed by Congress in September extends the tax moratorium until December of this year.

The Permanent Internet Tax Freedom Act (PIFTA) places major restrictions on Internet access taxation. The ban on taxes includes Internet access, data consumption, email, and other per bit levies by state and local governments. When consumers call up a web page or access their email, they often connect to a server that could be located a couple of blocks away, a couple of states away, or a couple of countries away.

Yet, eight states and a few cities in Colorado passed taxes before IFTA and have grandfathered tax regimes. The House passed bill would eliminate these exemptions. Since it limits the kinds of taxes on Internet, the bill has ramifications for broadband adoption, and thus the larger broadband competition debate.

Since the early 2000s, broadband adoption has taken off, resulting in countless political, economic, and social consequences. According to Pew, over 70 percent of private U.S. households now have broadband, while 3 percent have dialup.<sup>[2]</sup> The widespread adoption of broadband has been among the quickest adoptions of a technology in history, as a scant 3 percent had the service in 2000 when Pew began to ask this question.<sup>[3]</sup> The National Telecommunications and Information Administration also tracks adoption and their data closely parallels the Pew numbers, placing household adoption at 72.4 percent in October 2012.<sup>[4]</sup>

Only 15 percent of Americans are Internet non-adopters.<sup>[5]</sup> With so much of the economy moving online, the

reasons for non-adoption informs policy choices. As the extensive work in the digital divide literature has found, adoption of broadband is positively associated with higher income and greater levels of educational attainment, but tends to be lower for households that are older, rural, African-American, or Hispanic.<sup>[6]</sup>

## COMMUNICATION TAXES AS THEY CURRENTLY STAND

A key section of PITFA and all of its predecessors has been a limitation on Internet access taxes. A look at traditional telephone taxation portends the future without this provision.

According to the Tax Foundation, U.S. wireless consumers pay an average 17.05 percent in combined taxes and fees on their cell phone bill, including 11.23 percent in state and local charges.<sup>[7]</sup> For the states of Washington, New York, Florida, Illinois, Rhode Island, and Missouri this number exceeds 20 percent. Since the taxes are relatively hidden, states can enjoy all of the revenue benefits of higher rates without all of the political blowback. The State of Texas even went so far as to sue Sprint because the company listed a state tax as a line-item on its bill.<sup>[8]</sup>

Traditional wireline services are taxed at similarly high rates. Taxes on wired telephones averaged 17.23 percent in 2006, the last official data we could find.<sup>[9]</sup> Indeed, the FCC has a page dedicated to understanding the different categories of charges that are applied because there are so many taxes levied on telephone services.<sup>[10]</sup>

## COST OF PITFA & METHODOLOGY

Policymakers should be fully informed of how much it will cost broadband consumers if IFTA expires. If the state tax rates for wireless were applied, Internet consumers across all of the states could be forced to pay \$14.7 billion. Of these taxes, individuals would pay \$10 billion, while businesses would pay just under \$4.7 billion.

State	Estimated Wireless Taxes	Total Personal Taxes Per Year	Total Business Taxes Per Year	Total
Alabama	6.00%	\$91,387,188	\$26,023,326	\$117,410,514
Alaska	2.50%	\$6,778,215	\$2,346,068	\$9,124,283
Arizona	11.55%	\$251,938,210	\$91,873,665	\$343,811,875
Arkansas	9.38%	\$88,412,840	\$27,486,887	\$115,899,728
California	8.77%	\$1,201,929,780	\$583,579,106	\$1,785,508,886
Colorado	7.63%	\$149,017,334	\$70,594,678	\$219,612,011
Connecticut	6.35%	\$86,504,831	\$38,341,803	\$124,846,634

State	Estimated Wireless Taxes	Total Personal Taxes Per Year	Total Business Taxes Per Year	Total
Delaware	5.00%	\$16,900,860	\$7,071,755	\$23,972,615
DC	10.00%	\$31,197,660	\$45,170,763	\$76,368,423
Florida	15.53%	\$1,108,481,300	\$556,826,793	\$1,665,308,094
Georgia	5.74%	\$196,102,772	\$92,349,473	\$288,452,245
Hawaii	4.97%	\$26,468,023	\$8,804,992	\$35,273,016
Idaho	0.00%	\$0	\$0	\$0
Illinois	12.50%	\$559,043,175	\$280,160,151	\$839,203,326
Indiana	8.52%	\$176,100,629	\$63,023,744	\$239,124,374
Iowa	6.50%	\$58,678,152	\$21,936,140	\$80,614,292
Kansas	7.98%	\$73,790,789	\$49,379,317	\$123,170,105
Kentucky	8.80%	\$123,250,670	\$46,978,539	\$170,229,209
Louisiana	3.00%	\$48,634,650	\$17,076,098	\$65,710,748
Maine	5.00%	\$20,372,940	\$6,026,329	\$26,399,269
Maryland	10.10%	\$223,145,986	\$89,684,501	\$312,830,487
Massachusetts	6.25%	\$157,105,238	\$67,706,307	\$224,811,545
Michigan	6.00%	\$188,074,404	\$111,824,076	\$299,898,480
Minnesota	7.71%	\$137,746,042	\$73,252,415	\$210,998,458

State	Estimated Wireless Taxes	Total Personal Taxes Per Year	Total Business Taxes Per Year	Total
Mississippi	7.00%	\$65,014,698	\$17,412,858	\$82,427,556
Missouri	14.58%	\$279,840,559	\$146,281,313	\$426,121,872
Montana	3.75%	\$12,541,612	\$3,460,679	\$16,002,292
Nebraska	13.13%	\$76,561,713	\$36,214,669	\$112,776,382
Nevada	1.54%	\$15,616,395	\$7,130,764	\$22,747,158
New Hampshire	7.00%	\$32,668,188	\$11,165,089	\$43,833,277
New Jersey	7.00%	\$243,224,310	\$110,298,062	\$353,522,372
New Mexico	7.60%	\$48,002,527	\$15,016,215	\$63,018,742
New York	14.68%	\$1,077,118,870	\$446,002,909	\$1,523,121,779
North Carolina	7.00%	\$221,600,400	\$103,084,508	\$324,684,908
North Dakota	9.00%	\$23,022,954	\$8,216,603	\$31,239,557
Ohio	7.88%	\$308,685,068	\$142,823,927	\$451,508,995
Oklahoma	8.45%	\$105,016,634	\$35,947,725	\$140,964,359
Oregon	0.23%	\$3,144,989	\$1,322,470	\$4,467,460
Pennsylvania	12.00%	\$532,147,320	\$206,805,530	\$738,952,850
Rhode Island	12.00%	\$44,299,656	\$18,031,214	\$62,330,870
South Carolina	9.25%	\$133,804,007	\$46,430,316	\$180,234,323

State	Estimated Wireless Taxes	Total Personal Taxes Per Year	Total Business Taxes Per Year	Total
South Dakota	10.15%	\$27,726,857	\$7,449,885	\$35,176,742
Tennessee	9.50%	\$198,102,588	\$89,987,748	\$288,090,336
Texas	8.25%	\$765,949,784	\$426,828,628	\$1,192,778,412
Utah	10.30%	\$91,509,732	\$47,955,720	\$139,465,452
Vermont	6.50%	\$13,408,356	\$4,768,148	\$18,176,504
Virginia	5.00%	\$142,687,170	\$69,969,097	\$212,656,267
Washington	16.65%	\$409,346,744	\$208,796,296	\$618,143,040
West Virginia	0.00%	\$0	\$0	\$0
Wisconsin	7.09%	\$119,501,284	\$56,556,164	\$176,057,448
Wyoming	5.50%	\$10,896,204	\$3,252,077	\$14,148,281
Total		\$10,023,139,833	\$4,648,953,785	\$14,672,093,618

Estimating the costs of PITFA expiring begins first with the FCC's state by state estimates of broadband, which the agency breaks down into business and residential customers.<sup>[11]</sup> Total business connections includes both government entities and nonprofits organizations, and because they would not be subject to sales tax, each of the state's business connections were adjusted. This was achieved by first obtaining the total number of private and government jobs as provided by the Bureau of Labor Statistics.<sup>[12]</sup> This number was further depreciated by estimates of nonprofit employment as a percentage of private employment in each state as estimated by scholars at the Center for Civil Society Studies at the Johns Hopkins University.<sup>[13]</sup> Taken together, state by state percentage of the private workforce without non-profits are estimated. As expected, the District of Columbia workforce was the lowest at about 50 percent private (excluding non-profits and government workers) and Nevada was the highest at about 85 percent. The FCC business connection numbers were thus adjusted by each of the state's figures.

From here, total taxable receipts for each of the states could be estimated by multiplying the residential broadband connections by the estimated cost per month of \$42.55, which is an inflation adjusted number from

Pew survey data.<sup>[14]</sup> This number falls towards the low end of estimates of the average cost of broadband.<sup>[15]</sup> The same was done with business connections by multiplying the adjusted broadband connections by the estimated cost.<sup>[16]</sup> After tallying the 12 months of taxable receipts, they were then multiplied by a widely accepted estimate of total taxes on wireless phones to yield \$14.7 billion.<sup>[17]</sup> It should be noted that each of the state tax rates exclude both federal and state Universal Service Fund (USF) and 911 charges, which would not be applied to Internet services because of the regulatory title under which Internet is placed.

Although Internet access has become such an ingrained piece of everyday life, new taxes would induce consumers to downgrade their service, putting the brakes on quickly rising average speeds and placing downward pressure on investment. Moreover, there is evidence to suggest that consumers are choosing higher tiers of service than they did in 2010, so the cost estimates are likely to be even lower than the current average price being paid.

## CONCLUSION

Sales taxes often hit the poorest the hardest and that is where the burden of new Internet access taxes would fall.<sup>[18]</sup> Letting the Internet Tax Freedom Act sunset could cost consumers nearly \$14.7 billion a year in taxes. Internet access would be subject to myriad taxes that are currently being applied to wired and wireless. With the FCC already considering burdening large swaths of the Internet with new regulations, the brunt of the high taxes could add yet another drag onto the most dynamic part of the economy.

<sup>[1]</sup> <http://taxfoundation.org/blog/house-judiciary-committee-passes-permanent-internet-tax-freedom-act>