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No Internet Tax? Don't Be So Sure

By George A. Pieler

In 2004 Congress passed and President Bush signed into law a three-year extension of the Internet Tax Moratorium, which has been in effect almost continually since 1998. Americans thus don't have to worry about paying extra taxes for their access to the Internet, over and above what they already pay on telecom services.

Or do they?

As the Internet matures into a routine component of our daily lives, its independence from both taxation and regulation is rapidly eroding. Absent a more sweeping federal intervention to secure the Internet's freedom, it will be an increasingly rich target for revenues and regulatory interference from all directions. Moratorium or not, the Internet already is being viewed as a potentially lush revenue source at the state, local, and even international level.

State and Local Threats

Since the moratorium on Internet taxation was devised as a check on discriminatory and distracting state and local taxes, it is striking that those governments still succeed in drawing some new revenue off the Internet. To be sure, the moratorium always has "grandfathered" certain state tax initiatives put in place before its original enactment, and the 2004 extension of the moratorium further complicated the situation by implying it would be okay, for example, to tax VoIP services (Voice over Internet Protocol). The ostensible rationale was that VoIP is a competitor to traditionally taxed telephone services, and that the Internet should not make it a safe harbor from taxation.

The problem is that a tax on VoIP can't be distinguished from a tax on the ISP services that facilitate VoIP, and the VoIP tax rate could be set so high that it implicitly becomes an Internet service tax. The only check on that tendency is the notion that a "level playing field" among all types of phone service providers requires that a VoIP tax be limited to the tax rate imposed on more traditional phone services.

It would be better still if competition from VoIP and other services yet to emerge were used as an occasion to rethink telecom taxation from the ground up, especially in the direction of reducing or eliminating such taxes altogether.

Florida rejected an expanded definition of its telecom tax that would embrace VoIP. However, the city of Chicago has told VoIP customers they must pay the same telecom tax that applies to traditional and wireless phone services. Clearly for state and local governments alike, VoIP is seen as a juicy target for future revenue growth. Just how juicy is unclear, as the Federal Communications Commission (FCC) in November 2004 ruled that VoIP was presumptively a federal issue (implying possible federal preemption of state taxing authority in this area), but the scope of the FCC's ruling remains unclear.

Federal Threats

The enthusiasm for VoIP taxation is not confined to states and localities. Last spring the congressional Joint Committee on Taxation proposed the option of raising revenue with an expansive redefinition of telecom services covered by the federal telephone tax. This definition would have included VoIP and essentially all types of landline, satellite, and broadband services over which communication occurs. Only a brief uproar in Congress put the kibosh on this proposal, but there it lies on the revenue options table, waiting to be picked up by any eager tax-raiser on Capitol Hill.[1]

The FCC, moreover, is targeting VoIP for contributions to the "Universal Service Fund" (USF). The USF "dedicated fee" is a stealth tax, never directly legislated by Congress, whose very existence raises serious legal questions. The result is a program that has taken on a life of its own without even the minimum scrutiny and oversight provided by the congressional budget and appropriations process. If anything, this issue will grow in importance in 2006. For example, Reps. Lee Terry (R-Neb.) and Rick Boucher (D-Va.) are developing legislation to "regularize" and codify the USF on a very broad base indeed, defined as "universal services as of the date of enactment plus high speed broadband services and an evolving level of telecommunications services to be identified by the FCC." (Terry/Boucher Discussion Draft, Universal Service Reform Act of 2005, dated November 17, 2005.)

International Threats

While states, localities, and the feds fight over who has authority over the VoIP entry point into Internet taxation, striking things are happening on the international level. The World Summit on the Information Society, held in Tunis in November, rejected (for now) the notion of moving Internet governance from U.S.-based Internet Corporation for Assigned Names and Numbers (ICANN) to the United Nations; but in so doing the Summit participants agreed to establish mechanisms, forums, and goals that presume a vaguely defined international system to bring the economic, social, and cultural benefits of Internet access more rapidly to the developing world. The Tunis agreement includes under the heading "Financial Mechanisms" the statement, "We have considered the improvements and innovations of financing mechanisms, including the creation of a voluntary Digital Solidarity Fund," and the statement, "We underline that market forces alone cannot guarantee the full participation of developing countries in the global market for ICT-enabled services." (ICT stands for "Information and Computer Technology," obviously encompassing much more than the Internet.)

The aforementioned Digital Solidarity Fund (DSF) already exists, funded by several African nations, France, and the city of Geneva, Switzerland. Its method is to encourage donations of 1 percent of profits made by the private sector for "public technology projects" (i.e. government technology projects), creating a slush fund for virtually any technology project that, in the words of Kofi Annan, "empower poor and marginalized people." While DSF participation is voluntary and the fund is tiny, it is easy to see in this concept the kernel of a more robust, nonvoluntary financing mechanism (as UN authorities have long sought) levied against the private sector. Such a mechanism would enable the UN or an affiliated authority to bypass those troubling "market forces" that have fueled the global Internet revolution, leveraging the power of global bureaucrats and their allies in the less-developed world to decide who gets Internet access, and on what terms.

If a UN body is given this authority, it almost certainly would assert the right to levy a fee for the alleged purpose of funding programs to bridge the "digital divide." Such a fee might appear as a tax on domain registrations or renewals. Perhaps the only thing worse than the United States' USF would be a UN-administered version designed to extend Internet and related technologies to poor ("underserved") nations. As with virtually all UN programs, the goal might sound noble, but the result would be graft, corruption, extortion, and utter failure to accomplish the stated goals.

While merely a footnote in the story of the Internet to date, the DSF and its corollary presumption—that large-scale global interference by government is essential to bring the blessings of modern technology to all the world's peoples—is a troubling sign. As in the United States itself, the universal assumption that the Internet should be minimally regulated, and not taxed *per se*, rapidly seems to be vanishing. Since Internet freedom has brought more wealth to the world (including, one way or another, the world's poor) than any other phenomenon in the postwar era, this shift in attitude is a serious concern.

Before the Internet Tax Moratorium expires in 2007, Congress and the executive branch should seriously review Internet taxation from the local, state, national and international perspective, and determine how best to sustain the largely tax-free Internet that has done more good for the world than any bureaucracy ever could.

[1] Clouding the picture is that three federal judicial circuits have ruled that the federal telephone tax cannot be imposed on call plans priced by call time rather than by the "distance" the call travels. As USA Today reports, this would mean "cellular phones, Internet phone service, and about one-third of long-distance calls would be exempt from the tax." In theory this could lead to VoIP exemption from the telephone tax, but the legal situation remains in flux.

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