

## Multistate Tax Commission



### **STUDY: 'NET TAX MORATORIUM WOULD COST CITIES, STATES UP TO \$9 BILLION A YEAR, CREATE BLANKET TELCOM TAX EXEMPTION'**

*Unintended Side-Effect: Bill Language Goes Beyond Access Taxes to Wipe Out All Telcom-Related Levies; States, Local Governments Understand Need for Unburdened Internet Access for Consumers.*

**WASHINGTON, D.C. – September 24, 2003** – The Internet tax moratorium passed by the U.S. House of Representatives on September 17, 2003 would end up reducing state and local revenue collections by at least \$4 billion and as much as \$8.75 billion annually by 2006, rather than the \$500 million estimated cost under the legislation's narrower original focus. These figures are contained in a study released today by the Multistate Tax Commission (MTC). The prospect of unintended -- but no less staggering -- new multi-billion-dollar losses for local and state governments would result from language in the House bill, H.R. 49, that courts could interpret as providing a blanket exemption from non-federal taxes for the telecommunications industry, granting it an unprecedented "church"-like status.

The MTC study concludes: "... H.R. 49 – by preempting a variety of activities that go beyond access by customers to the Internet and by expanding the scope of the preemption to income, property and other business taxes – will reduce revenues from current taxes levied by the 50 states, the District of Columbia and local governments a minimum of \$4 billion and up to \$8.75 billion annually by 2006. Whether the losses rise to the higher level depends on the outcome of anticipated litigation over the provisions of H.R. 49, if enacted. The estimates above are conservative because they do not include the full impact of services, information and content that can be exempted from tax by being bundled with Internet access or offered as a service over the Internet. In contrast, if the language of H.R. 49 were amended to conform to Congress' intent of preempting only sales taxes on solely Internet access to customers, including broadband, and extending the preemption to 'grandfathered' sales taxes of certain states, the cost to state and local governments would be limited to approximately \$500 million in 2006."

Commenting on the new MTC study, Tennessee Revenue Commissioner Loren Chumley said: "State revenue commissioners and other state and local officials understand that consumers need to be able to get Internet access and we are not disputing the original \$500 million 'bite' that H.R. 49 presented to us. But state tax officials have many decades of experience living with the effects of laws passed by Congress. Our legal reading of the new expansive language in H.R. 49 is that it will effectively rope off the telecommunications industry from local and state taxes. It does not matter if the legislation's proponents insist that was not their intention here. Intention doesn't count in court when it comes to tax matters. All that counts is what the bill says – and this bill provides a roadmap for the telecommunications industry to sidestep as much as \$9

billion annually by 2006 in taxes and succeed in doing what no other industry has done: get Congress to relieve it of potentially all local and state taxes.”

Government Finance Officers Association President Ed Harrington, who also is controller for the city and county of San Francisco, said: “When the House voted for H.R. 49 they were told that it would cost state and local governments \$80 to \$120 million because of the change to get rid of the ‘grandfather’ clause affecting sales taxes in the prior temporary moratorium. However, the Congressional Budget Office noted that changing the definition of what constitutes Internet access could also affect other tax revenues – but could not give an estimate. We believe that losing \$80 to \$120 million annually – \$45 million from Texas alone – is reason enough to question this bill. However, the grandfather clause as it applies to sales taxes affects only about 10 states ... Much more serious in our view is the expansion of the definition of Internet access to include telecommunications services. This could have a dramatic impact on virtually all state and local governments that collect any kind of tax on telecommunications companies – utility taxes, franchise taxes, gross receipts, property and other taxes could be called into question. All of this in a bill that has been touted as only making permanent the current temporary ban on taxes on Internet access charges.”

Jim McIntire, chairman of the Washington state House Finance Committee, said: “We’ve addressed this legislative question already in Washington state, so I know that the ‘fix’ that is needed to H.R. 49 is a simple matter. I see this as a basic question of business fairness. It is inconceivable to me that we would grant a church-like status to the telecommunications industry while insisting that other industries pay their full share. Internet access is one thing – but stretching a \$500 million tax relief measure into a gaping \$9 billion hole at a time when cities, counties and states already are struggling is unconscionable.”

### **OTHER KEY STUDY FINDINGS**

The loss of telecommunications revenue will grow after 2006 until the industry becomes virtually exempt from state and local taxes. The Multistate Tax Commission study notes: “H.R. 49 will eventually exempt all or nearly all of the telecommunications industry from major state and local taxes: sales, excise, income, property and other taxes. The date when the virtual exemption from state and local taxes occurs depends on the speed at which the industry completes the conversion of its services to the Internet – a technological change now clearly underway. The point of virtually complete exemption from state and local taxes will occur earlier in some states and localities than others. If the current language of H.R. 49 had been in effect in 2002 and if the industry had completed the transfer of its services to the Internet, the revenue loss to state and local governments would have been \$22 billion.”

The study points out that the state and local consequences of losing up to \$9 billion in revenues would be considerable. According to the MTC report: “... the National Center for Education Statistics projects that it will cost state and local governments \$8,557 for each pupil enrolled in public elementary and secondary schools in 2005. Every \$1 billion that would be preempted by this proposed legislation, and not made up by other revenues, or reductions in other services could have been used to provide education for nearly 117,000 pupils. Similarly, at 2001

compensation rates, each \$1 billion in state and local revenues preempted by this legislation translates to nearly 20,000 fewer policemen on ‘the beat’ or nearly 20,000 fewer firefighters, or more than 27,000 hospital workers. Similarly, for each \$1 billion preempted, there could be nearly 25,000 fewer instructional staff in public elementary and secondary schools or more than 17,000 fewer instructional personnel in college classrooms and laboratories.”

For the full text of “Revenue Impact on State and Local Governments of Permanent Extension of the Internet Tax Freedom Act” go to <http://www.mtc.gov>.

### **BACKGROUND: JULY 2003 TAX SHELTER STUDY**

On July 15 2003, the MTC released a separate report showing that corporate tax sheltering is linked to as much as \$12.4 billion in lost state tax revenues. The July 2003 data indicate that state corporate income tax revenue, which totaled \$35.4 billion in 2001, would have been as much as \$12.38 billion (or 35 percent) higher had such widespread tax sheltering of income not taken place. The full text of the earlier MTC study, including revenue losses for individual states, is available on the web at <http://www.mtc.gov/statebudgetcrisis.html>.

### **ABOUT THE MTC**

The Multistate Tax Commission was created in 1967 and 45 state governments now participate in the MTC. The Commission encourages states to adopt uniform tax laws and regulations that apply to multistate and multinational enterprises. Greater uniformity in multistate taxation reduces compliance burdens for multistate businesses and helps ensure that interstate commerce is neither undertaxed nor overtaxed.

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**EDITOR’S NOTES:** A streaming audio replay of a related news event will be available as of 6 p.m. EDT on September 24, 2003 on the Web at <http://www.mtc.gov>. This is the same location where the MTC report will be available for review.