

Highlights of [GAO-06-273](#), a report to congressional committees

# INTERNET ACCESS TAX MORATORIUM

## Revenue Impacts Will Vary by State

### Why GAO Did This Study

According to one report, at the end of 2004, some 70 million U.S. adults logged on to access the Internet during a typical day. As public use of the Internet grew from the mid-1990s onward, Internet access became a potential target for state and local taxation.

In 1998, Congress imposed a moratorium temporarily preventing state and local governments from imposing new taxes on Internet access. Existing state and local taxes were grandfathered. In amending the moratorium in 2004, Congress required GAO to study its impact on state and local government revenues. This report's objectives are to determine the scope of the moratorium and its impact, if any, on state and local revenues.

For this report, GAO reviewed the moratorium's language, its legislative history, and associated legal issues; examined studies of revenue impact; interviewed people knowledgeable about access services; and collected information about eight case study states not intended to be representative of other states. GAO chose the states considering such factors as whether they had taxes grandfathered for different forms of access services and covered different urban and rural parts of the country.

### What GAO Recommends

GAO is not making any recommendations in this report.

[www.gao.gov/cgi-bin/getrpt?GAO-06-273](http://www.gao.gov/cgi-bin/getrpt?GAO-06-273).

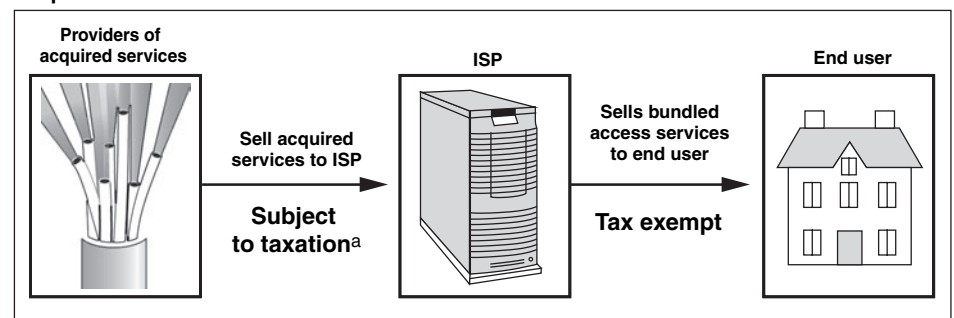
To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov).

### What GAO Found

The Internet tax moratorium bars taxes on Internet access services provided to end users. GAO's interpretation of the law is that the bar on taxes includes whatever an access provider reasonably bundles to consumers, including e-mail and digital subscriber line (DSL) services. The moratorium does not bar taxes on acquired services, such as high-speed communications capacity over fiber, acquired by Internet service providers (ISP) and used to deliver Internet access. However, some states and providers have construed the moratorium as barring taxation of acquired services. Some officials told us their states would stop collecting such taxes as early as November 1, 2005, the date they assumed that taxes on acquired services would lose their grandfathered protection. According to GAO's reading of the law, these taxes are not barred since a tax on acquired services is not a tax on Internet access. In comments, telecommunications industry officials continued to view acquired services as subject to the moratorium and exempt from taxation. As noted above, GAO disagrees. In addition, Federation of Tax Administrators officials expressed concern that some might have a broader view of what could be included in Internet access bundles. However, GAO's view is that what is included must be reasonably related to providing Internet access.

The revenue impact of eliminating grandfathering in states studied by the Congressional Budget Office (CBO) would be small, but the moratorium's total revenue impact has been unclear and any future impact would vary by state. In 2003, when CBO reported how much states and localities would lose annually by 2007 if certain grandfathered taxes were eliminated, its estimate for states with grandfathered taxes in 1998 was about 0.1 percent of those states' 2004 tax revenues. Because it is hard to know what states would have done to tax access services if no moratorium had existed, the total revenue implications of the moratorium are unclear. In general, any future moratorium-related impact will differ by state. Tax law details and tax rates varied among states. For instance, North Dakota taxed access service delivered to retail consumers, and Kansas taxed communications services acquired by ISPs to support their customers.

**Simplified Model of Tax Status of Services Related to Internet Access**



Source: GAO and PhotoDisc (images).

<sup>a</sup>Depends on state law.