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The Web: Tax policies far from settled

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UPI Science News

CHICAGO, Dec. 1 (UPI) — President Bush is expected to sign the Internet Tax Nondiscrimination Act soon, which will ban federal and state tariffs on almost all online connections -- from dial-up to broadband -- for the next four years. Technology and legal experts told UPI's The Web that the bill, while important, far from settles the government's Internet policy.

"This foreshadows a more important debate," said Adam Thierer, director of telecommunications studies at the Cato Institute, a free market think tank in Washington D.C. "That coming debate will be about broadband services -- and telecommunications tax reform."

Congress and the Bush administration have been debating the future of the high-speed Internet for some time. In October Congress approved a temporary measure extending an existing moratorium from 1998 on online taxes for another year. The permanent bill, passed by the Senate earlier and by the House Nov. 19, is considered a compromise by analysts because it ends tax discrimination against digital subscriber line technology, said Carol Cayo, director of government affairs in the Washington office of Vertex Inc., a developer of tax calculation software for businesses and government.

"One of the big impacts is that the moratorium is technologically neutral, which is new," Cayo told The Web.

Bush's aides, including Treasury Secretary John Snow, this fall publicly advocated the Senate version of the legislation, bolstering support in the House. Outgoing Commerce Secretary Don Evans also supported the bill.

There are a number of legends about the legislation that have been reported in the media, however, tales that simply are not true, experts said.

"There is a misreported myth here," Thierer told The Web. "Congress is not banning Internet taxes here. Congress is banning Internet access charges. This is not a sweeping ban on all taxation. That is commonly misunderstood."

Cayo added that state taxes on DSL connections will be "grandfathered" under the bill -- also known as S. 150 -- for two years and then will simply disappear.

"Basically, the extension amounts to a decision to leave things pretty much the way they were until they can decide what they really want to do," said Nick Nesi, a tax partner in the New York City accounting firm BDO Siedman.

One of the big issues the bill presages during the next Congress is whether Internet telephony -- called Voice Over Internet Protocol or VOIP -- should be subject to taxation. This is a divisive issue, experts said. States sent lobbyists out this past fall to make sure the moratorium that just passed the Congress did not exempt Internet telephony from taxation.

"What is at stake in this, in the long run, is taxing voice over the Internet. VOIP -- that's the next cash cow," Thierer said. "E-commerce is not as big as the government thought it

would be. Department of Commerce figures show that e-commerce is about 3 percent of all retail, despite all of the hype that it is getting. The government at first thought that e-commerce would be a big drain on tax revenues, but that has not proven to be the case."

Now, state and local governments are concerned that Internet telephony -- which is free in some cases or costing only a few pennies a minute in others, depending upon the connection -- is going to bankrupt them. That is because governments receive a huge portion of their tax revenues from taxes on utilities -- telephone, water, natural gas and electricity services. With some 200 million Americans now online, the stakes are quite high, making the issue one for working families.

"Utility industry receipts are a big cash cow for them," Thierer said. "Some entire school districts -- one in Ohio that I'm thinking of -- have all of their education funded on taxes from utilities: electric, water and telecom. That is going to have to end at some point. In the past, it was easier for state and local government to tax local monopoly providers.

"They were easy to tax. They were right there. Now that argument no longer stands, because of the rise of alternative technologies, like VOIP, this system will break down at some point," he said. "That's the tipping point -- it challenges all the traditional assumptions about telecom regulations."

Nesi noted that local and state tax revenues from telephony alone are approximately \$20 billion a year.

"They can't afford to have an erosion of that base," he said. "Making Internet telephony tax-free would put states into a worse position."

Experts said with the moratorium in place for four years, Congress should be able to debate what the state governments say they really want -- telecom tax reform.

"This sets the tone for that, and serves as a placeholder on these issues," Cayo said. "This will be an important issue for the next Congress -- there are different camps and they all have strongly held beliefs."

Some interest groups, however, such as the Direct Marketing Association -- which represents online direct marketers and offline direct mail houses -- still would like Congress to revisit the moratorium one more time.

"The DMA continues to favor making the moratorium permanent," Louis Mastria, the association's director of public and international affairs, said in a statement.

Eliminating taxes on online access will make the Internet "more affordable and accessible for all Americans," said Dave Baker, vice president of law and public policy at Earthlink the Internet service provider in Atlanta.

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