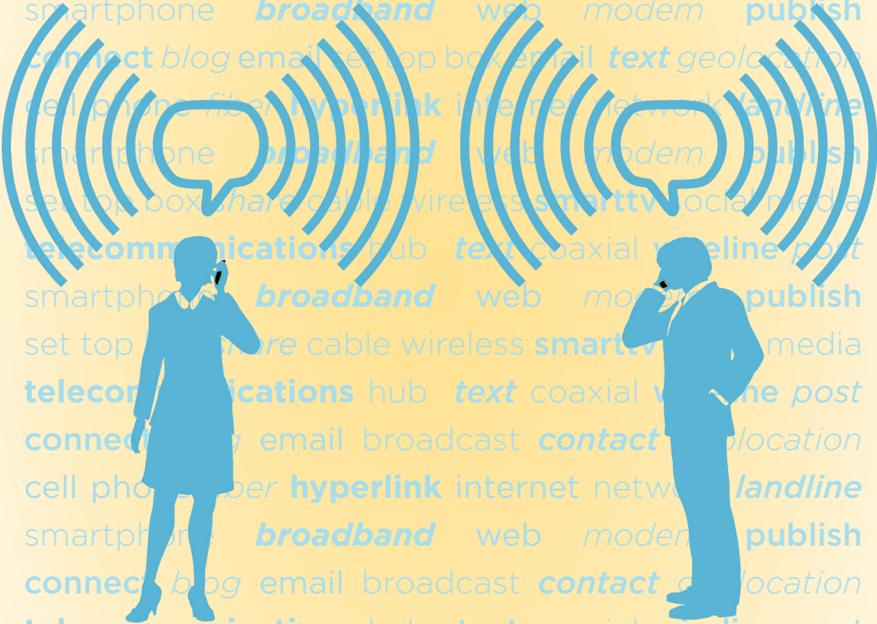


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Telecom Unplugged:

Ushering in a New Digital Era

By Deborah S. Collier
and Thomas A. Schatz

TELECOM UNPLUGGED: USHERING IN A NEW DIGITAL ERA

INTRODUCTION

In October 2007, Citizens Against Government Waste (CAGW) published *Telecom Regulation: Pulling the Plug on Government Interference*. The report noted that the rapid deployment of new technology was leaving a bevy of federal regulations over the telecommunications and cable industries in the dust. Today's converging communications and information technology (IT) environment has greatly enhanced and expanded how people around the world communicate and share information. The rapid adoption of Smartphone technology has enabled people to carry computers in the palms of their hands, and today's college freshmen are routinely equipped with laptops, cell phones, and tablets. The list of new mobile computing devices grows daily. This report, *Telecom Unplugged: Ushering in a New Digital Era*, updates CAGW's 2007 report.

Music and video are no longer limited to the living room but can be enjoyed through a wide range of options, including cable, fiber optic, satellite, and broadband, as well as wireless devices, anywhere at any time. Social media platforms including Facebook, Twitter, Pinterest, and others have become major sources of information sharing. At the 2013 Cable Show, cloud-based video platforms were introduced by Comcast and Time Warner Cable that would provide video programming and storage to consumers. Despite these innovations, the communications industry is still saddled with a regulatory regime that harkens back to the early 1930s and, for common carriers, back to the early days of the railroad industry in the late 1800s.

The Communications Act of 1934 was the first formal attempt to provide regulatory continuity to the growing telephone industry as it began to reach across the nation and connect people thousands of miles away from each other through a copper-wire line. In 1992, the Cable Act was passed in response to concerns that the broadcast industry needed protection when dealing with cable companies. The Telecommunications Act of 1996 further regulated both the telephone and cable industries following the breakup of the Bell companies.

None of those laws foresaw today's rapidly changing innovative marketplace, nor did they account for any future changes in technology that will greatly expand communications. While the communications industry continues to rapidly evolve, the federal government moves at a

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snail's pace to adapt, leaving in place old models governing technology and communications that should no longer apply to modern times. Unfortunately, these obsolete telecommunications regulations are stifling innovation and putting taxpayers and consumers at risk.

In his 1984 book, *Burning Money, The Waste of Your Tax Dollars*, that summarized the Grace Commission's findings, Peter Grace described the technological ignorance pervading the federal government. At the time of the book's publication, the average age of a government computer was 6.7 years; the average computer used by a U.S. business was three years old. Government computer systems were incompatible and required service technicians specifically trained to maintain the outdated equipment. The extra bodies added \$1 billion to the federal payroll over a three-year period. Meanwhile, in the private sector, IBM's General Systems Division updated its computer technology, saving \$360,000 in the first six months after installation, and the Boeing Military Airplane Company's new word processing system saved \$483,000 over a nine-month period.

In the 30 years since Mr. Grace published his book and co-founded CAGW with syndicated columnist Jack Anderson, the federal government's technological ineptitude has persisted. The current telecommunications debates and the federal government's attempts to regulate the industry are symptoms of larger problems.

From 1989 to 2000, 223 bills were introduced in Congress dealing with some portion of the telecommunications industry; 22 of them, including the Telecommunications Act of 1996, were signed into law. From 2001 to 2010, only 78 such bills were introduced, seven of which became law. The 2012 edition of Title 47, the chapter of the U.S. Code governing the telecommunications industry, now encompasses 3,668 pages. While the private sector speeds ahead with more innovation in response to consumer demand, the federal government lags behind trying to play catch up and fails to see the impact of its policies on taxpayers and consumers.

The telecommunications industry generates approximately \$347 billion annually or 2.4 percent of the GDP as measured by output, labor, input, investment and international trade;¹ and provides 2 million

¹ OECD (2013), "STAN Industry Rev. 4," STAN: OECD Structural Analysis Statistics (database), Doi: 10.1787/3151-00649-en, http://www.oecd-ilibrary.org/industry-and-services/data/stan-oecd-structural-analysis-statistics/stan-industry-rev-4_data-00649-en;jsessionid=h5cd4n3j3vr9.x-oecd-live-01?isPartOf=/content/datacollection/stan-data-en.

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direct and indirect jobs.² Yet this innovative and important sector of the economy remains hampered with antiquated laws and regulations.

This paper reviews several areas where government intervention or lack of intervention harms taxpayers and consumers. Topics include the implications of current and proposed Internet tax laws, federally funded broadband deployment, the provision of tools such as spectrum to enable improved communications across the nation, and Internet governance issues in the United States and around the world.

²“Industry Data,” National Cable and Telecommunications Association, <https://www.ncta.com/industry-data>.

CHAPTER I: THE TAXING PROBLEM OF INTERNET TAXATION

The Internet has been generally free from excessive government intervention since it was first opened up for general public use in 1992. However, as state and local governments seek new revenue streams to combat increasingly strained budgets, numerous proposals to tax access to the Internet and the services that it provides have been introduced. The federal Internet tax moratorium expires on November 1, 2014. Some states are already imposing taxes on digital goods. There is an ongoing debate over where to draw the line on online sales taxes. States are seeking guidance from the federal government for clarification on whether, how, and when Internet taxes should apply. This chapter seeks to provide clarification and guidance on these issues.

MAKING THE INTERNET TAX MORATORIUM PERMANENT

The lack of intervention in the development of the Internet has contributed to its remarkable growth. Whether buying products, researching information, or emailing friends or business associates, the Internet has changed how everyone shops, banks, shares information, and communicates around the globe.

In 1998, the Internet Tax Freedom Act placed a moratorium on discriminatory taxes on the Internet. With large bipartisan support, the Internet tax ban was extended in 2001, 2004 and 2008. The most current moratorium expires in November 2014. For 16 years, the ban on these inequitable taxes has benefited millions of Americans by enabling them to conduct transactions on the Internet without discriminatory taxes or taxes on access. As the moratorium's expiration date looms, it is time to make this ban permanent.

As of February 27, 2013, the number of Internet users reached 2.7 billion; almost two billion more users than when the law was first enacted, and consisting of nearly 39 percent of the global population.³ Electronic commerce has become a larger part of the U.S. economy, accounting for \$57 billion in the third quarter of 2012, or 5.2 percent of total sales, and it is

³ International Telecommunications Union, "The World in 2013: ITC Facts and Figures," February 27, 2013, <http://www.itu.int/en/ITU-D/Statistics/Documents/facts/ICTFactsFigures2013.pdf>.

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increasing at around 15 percent per quarter.⁴

The federal Internet tax moratorium does not prohibit states from collecting sales or use taxes from their residents for purchases made either remotely or online. The moratorium simply prevents states from taxing access to the Internet or placing discriminatory duplicate taxes on Internet services.

During debate on the 2008 extension, some opponents argued that the tax ban hurts states' ability to raise revenues.⁵ However, in the nine states that were grandfathered under the 1998 Internet Tax Freedom Act and allowed to continue to impose taxes on Internet access, the revenue from that tax equals an average of 0.1 percent of the states' budgets. The nine states are: Connecticut, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, and Wisconsin.⁶ As a matter of fairness and creating a level playing field among all 50 states, any legislation that permanently eliminates Internet taxes should include the termination of the nine states' authority to tax Internet access.

There is widespread speculation as to how taxes would be levied if the moratorium is not continued or made permanent. The most likely choice is a tax on Internet access as allowed in the grandfathered states. Another suggestion, made and then rescinded by former Federal Communications Commission (FCC) Chairman Julius Genachowski, would involve the imposition of a "fee" on Internet access similar to the Universal Service Fund fee currently found on phone bills for provisioning broadband in unserved or underserved areas of the country. Some have suggested that taxes could also be applied to downloaded files and even emails.⁷

In other words, opening up the Internet to taxes on access would be just the tip of the iceberg. The Internet has never been open to pervasive taxation by government; it is impossible to predict the extent to which politicians may attempt to fill government coffers.

One of many problems with taxing the Internet is that when something becomes more costly, people will engage in less of it. If legislators are truly concerned about continuing to expand the availability and use of the

⁴ U.S. Census Bureau News, "Quarterly Retail E-Commerce Sales 3rd Quarter 2012," November 16, 2012, http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf.

⁵ Grant Gross, "Internet Tax Moratorium Bill Stalls," *NetworkWorld*, September 28, 2007, <http://www.networkworld.com/news/2007/092807-internet-tax-moratorium.html>.

⁶ E-Commerce Tax Policy Project, September 19, 2007, <http://www.bloch.umkc.edu/ecommerce/nondiscrimact.html>.

⁷ Phil Kerpen, "Coming this Fall: Internet Taxes?" *The National Review*, September 6, 2007, <http://article.nationalreview.com/?q=OGVIZjRiYWMyMDQyYTY4N2VjNzg4YTJhYTJjZGU5ZTQ=>.

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Internet, they should avoid imposing taxes on Internet services. Should the government decide to get involved, Internet businesses will lose customers. It is better to keep the status quo rather than to manipulate the free market.

As Congress faces the expiration of the moratorium, the ban should be made permanent and apply equally to all 50 states and territories. On August 1, 2013, Sens. Ron Wyden (D-Ore.) and John Thune (R-S.D.) introduced S. 1431, which would make the moratorium permanent and equally applied to all states and territories. Similar legislation (H.R. 3086) was introduced on September 12, 2013 by Reps. Bob Goodlatte (R-Va.) and Anna Eshoo (D-Calif.). Internet business and commerce have become an important part of the economy and the tax ban has been a contributing factor. As the economy will undoubtedly continue to be more digitally-focused, America has a lot to gain from keeping online activities unshackled from the burdens that come from excessive regulation and taxation.

ONLINE SALES TAXES AND THE MARKETPLACE FAIRNESS ACT

States and local governments are becoming increasingly concerned about the loss of revenue as Internet sales continue to expand. Instead of recognizing the positive impact of increased levels of production and entrepreneurship, many state and local governments claim that these sales evade their regional and local taxes and ultimately hurt citizens.

In Quill v. North Dakota, the Supreme Court held that under the Commerce Clause of the Constitution a state cannot require an out-of-state retailer to collect use tax unless the retailer has a “substantial nexus” with the taxing state.⁸ Siding with Quill, the court ruled that a taxpayer must have a physical presence, such as an office, branches, warehouse, or employees in a state in order to require collection of sales or use tax for purchases made by in-state customers.

Many states already require their citizens to pay taxes on remote sales, either through collection of sales tax by companies that have a physical presence within the state, or through a use tax which is collected at the end of the year and filed with the individual’s state income tax return. However, in the 45 states that have a use tax, only 1.6 percent of taxpayers in these

⁸ “Sale and Taxation of Goods Over the Internet, Substantial Nexus, Quill Corp. v. North Dakota, 504 U.S. 298 (1992),” Cyberspace Law seminar, University of North Carolina School of Law, May 2010, <http://www.unc.edu/courses/2010spring/law/357c/001/salestaxonline/quill-v-north-dakota.html>.

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states pay the tax.⁹ This is either because the process of reviewing statements for online purchases that did not include a sales tax is cumbersome, people are ignorant of the law, or they are intentionally avoiding the tax. In 1999, then-Governor William Janklow (R-S.D.) joked about using state troopers to pull over Federal Express and United Parcel Service trucks in order to find out which packages did not include state sales taxes. This comment reflected states' desperate efforts to collect as much revenue as possible.

Congress is currently debating the sales tax issue. On May 6, 2013, the Senate passed S. 743, the Marketplace Fairness Act of 2013. This legislation allows member states under the Streamlined Sales and Use Tax Agreement to allow businesses that operate in the state to collect sales and use taxes from out-of-state customers for the state and local jurisdictions in which the customer resides. This mandate would force small businesses not qualifying for the small-seller exemption of \$1 million annually to know and understand the tax laws of all 50 states and every local taxing authority if they want to do business over the Internet. There are nearly 9,600 separate taxing jurisdictions in the United States, and despite the exemption for small sellers, those not qualifying would be burdened with substantial costs to support the new system.¹⁰

The legislation uses this agreement as a baseline for states to follow in requiring remote sellers to collect taxes on their behalf. Participation by states is voluntary, but the proposed legislation would codify its existence, essentially creating an unelected governing body controlling remote sales tax regulations.

Proponents of the legislation claim they are attempting to create a level playing field between online and storefront commerce, often stating that consumers shop online to avoid paying a sales tax on purchases.¹¹ However, as noted, states that collect sales tax have a use tax that requires taxpayers to pay taxes on previously untaxed purchases when filing their state income tax returns. If this legislation becomes law, the playing field will become uneven for small businesses, as they compete against big box stores that are already collecting interstate sales taxes.

The bill's burdensome tax collection procedures will create additional

⁹ Chana Joffe-Walt, "Most People Are Supposed to Pay This Tax. Almost Nobody Actually Pays It," National Public Radio, Planet Money, April 16, 2013, <http://www.npr.org/blogs/money/2013/04/16/177384487/most-people-are-supposed-to-pay-this-tax>.

¹⁰ Paul Demery, "U.S. Senate Passes Web Sales Tax Bill," *Internet Retailer*, May 6, 2013, <http://www.internetretailer.com/2013/05/06/us-senate-passes-web-sales-tax-bill>.

¹¹ Jake Grovum, "The 'Amazon Tax' War Escalates," StateLine, The Pew Charitable Trusts, April 26, 2010, <http://www.pewstates.org/projects/stateline/headlines/the-amazon-tax-war-escalates-85899376821>.

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costs for retailers.¹² These costs will be passed on to consumers through higher retail prices for goods and services and will make it difficult for small, job-creating companies to succeed in today's marketplace.

An alternative to the scheme set up in the Marketplace Fairness Act would be the establishment of an origin-based sales tax system in which the tax is based on the origin of the seller instead of the buyer.¹³ Sellers would be responsible for collecting sales tax, but like brick-and-mortar sellers, they would be responsible for collecting sales taxes only in the jurisdiction in which they are located, rather than collecting for 9,600 other jurisdictions. The benefit to small businesses competing online are obvious; however, in this model, residents of the five states that currently do not charge sales tax (Alaska, Delaware, Montana, New Hampshire, and Oregon) would be subject to a new tax for purchases made remotely outside their states.¹⁴ States that provide an origin-based sales tax format include Arizona, California, Illinois, Mississippi, Missouri, New Mexico, Pennsylvania, Tennessee, Texas, Utah, and Virginia.¹⁵

Rather than trying to collect sales taxes from remote sellers, states should eliminate waste in order to fund needed government services. The Marketplace Fairness Act does not make the marketplace truly fair for brick-and-mortar and remote sales.

WIRELESS TAXES ARE TOO COSTLY TO CONSUMERS

According to a November 2012 survey by the Pew Internet & American Life Project, nearly 85 percent of American adults own a cell phone. These wireless devices now play a key role in many aspects of their daily living. The survey found that 67 percent of cell phone owners regularly check their phones for messages, 44 percent have slept with their phones beside their beds to make sure they don't miss an important call, and 29 percent describe their phones as "something they can't imagine living without."¹⁶

¹² Grant Gross, "Tech Groups Oppose Internet Sales Tax Bill," *PCWorld*, IDG News Service, August 2, 2011, http://www.pcworld.com/article/237030/tech_groups_oppose_internet_sales_tax_bill.html.

¹³ Andrew Moylan, "An 'Original' Solution to Taxation of Online Sales," *InsideALEC*, June 2012, <http://www.alec.org/wp-content/uploads/April-2012-Moylan-Online-Sales1.pdf>.

¹⁴ Hanns Kuttner, "Taxing Sales: Comparing the Origin-Based and Destination-Based Models," Hudson Institute, Economic Policy/Briefing Paper, June 2012, <http://www.hudson.org/files/publications/TaxingSales--Kuttner0612web.pdf>.

¹⁵ "Destination and Origin-based Sales Tax," Sales Tax DataLINK, April 8, 2013, <http://www.salestaxdatalink.com/destination-and-origin-based-sales-tax/>.

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In this era of mobile connectedness, wireless subscribers have grown from 48.7 million in 1997 to 321.7 million in 2012.¹⁷ As the use of wireless communications increases, so does the number of households foregoing land lines or wired telephone service in favor of wireless devices. According to the Centers for Disease Control (CDC), the percentage of adults and children living in households with only wireless telephone service or no telephone service has increased from just over 4 percent in 2004 to approximately 34 percent of adults and 40.6 percent of children in 2012.¹⁸

While the number of wireless consumers is on the rise and a greater number are choosing to “cut the cord” on their landline connections, state and local tax burdens have also skyrocketed. An October 29, 2012, report by Scott Mackey of KSE Partners showed that taxes on wireless consumers are rising at a steady pace.¹⁹

The telecommunications industry, which provides innovation and economic growth to the country, is one of the most heavily taxed businesses in the nation. The Mackey report provides a detailed state-by-state analysis of the taxes wireless consumers now pay. The state of Nebraska has the highest combined wireless tax rate at 24.49 percent and Oregon has the lowest combined tax rate at 7.67 percent. Rounding out the top five highest wireless tax states are Washington (24.44 percent), New York (23.67 percent), Florida (22.41 percent), and Illinois (21.76 percent). According to the report, the average burden from wireless taxes and fees on consumers has increased from 16.26 percent in July 2010 to 17.18 percent in July 2012. Yet the average state and local sales tax for other goods and services is currently 7.33 percent.

One of the primary sources of the 2010-2012 increase is the federal Universal Service Fund (USF) contribution rate, which is a hidden tax passed on to consumers. In 2003, the contribution rate was 7.3 percent. It more than doubled to 15.7 percent by 2012. In addition to increases in the federal USF fee, several states are duplicating the federal government’s efforts by placing a surcharge on intrastate telecommunications services. These funds

¹⁶ “The Best (and Worst) of Mobile Connectivity,” Pew Internet & American Life Project, November 30, 2012, http://www.pewinternet.org/-/media/Files/Reports/2012/PIP_Best_Worst_Mobile_113012.pdf.

¹⁷ “Wireless Quick Facts, CTIA, The Wireless Association, Year-End Figures, 2012,” <http://www.ctia.org/advocacy/research/index.cfm/AID/10323>.

¹⁸ Stephen J. Blumberg, Ph.D., and Julian V. Luke, “Wireless Substitution: Early Release of Estimates from the National Health Interview Survey, January - June 2012,” Centers for Disease Control, December 2012, <http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201212.pdf>.

¹⁹ Scott Mackey, “Wireless Taxes and Fees Continue Growth Trend,” State Tax Notes, October 29, 2012, <http://www.ksefocus.com/wordpress-content/uploads/2012/11/mackey-state-tax-notes.pdf>.

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are typically used to support basic local telephone service in areas where it is costly to provide such services. Among the states with their own USF fees are Alaska (5.98 percent), Colorado (1.82 percent), Indiana (.33 percent), Kansas (.17 percent), Louisiana (2.4 percent), Maine (.94 percent), Maryland (.38 percent), Nebraska (4.37 percent), Nevada (.1 percent), New Mexico (2.08 percent), Oklahoma (1.98 percent), Texas (2.7 percent), Utah (.63 percent), Vermont (1.6 percent, including 911), Wisconsin (.1 percent), and Wyoming (.63 percent).²⁰

As noted in the Mackey report, most states also impose a 911 fee on consumers' wireless bills, as well as state and local wireless taxes and other fees. The 911 program provides consumers of telephone services contact to emergency personnel; the Enhanced 911 program (E-911) allows consumers to reach emergency services regardless of the technology used to place the call. Most of the taxes and fees listed in Mackey's report are passed along to subscribers.

On June 12, 2013, legislation was introduced in the House of Representatives to address the disparities and halt the increases in wireless taxes. The Wireless Tax Fairness Act (H.R. 2309) would place a five-year freeze on attempts by state and local governments to raise taxes on wireless services, including mobile services, mobile service providers, or mobile service property. On June 26, 2013, a Senate companion bill, S. 1235, was introduced. Similar legislation passed the House of Representatives during the 112th Congress, but was not considered by the Senate.

With wireless tax rates above the 20 percent mark in some states, these discriminatory taxes hit the poorest in the nation hardest, creating obstacles for them to opt for wireless communications over land lines. The ability to communicate efficiently and effectively through technologies such as wireless broadband and cell phones is essential in today's increasingly connected society and should not be hindered by onerous taxes.

RAIDS ON 911/E-911 FUNDS: PROGRESS BEING MADE

Many of the older 911 communications systems have difficulty in pinpointing an individual's location if that person is using a mobile device to call for help. As more individuals use new technologies to contact 911 services for assistance, these systems must be able to find them regardless of how they are communicating. The existing 911 system is mostly funded by

²⁰ Ibid.

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wireless consumers through the E-911 fee or tax on their communications bill, although wireless providers also invest resources to support 911 services over their wireless networks and devices.

In 2004, Congress enacted the ENHANCE 911 Act (Public Law 108-494) following the 9/11 Commission's recommendation to improve coordination and integrate communications for emergency first responders. The legislation was intended to assist states in modernizing their 911 systems.²¹ This legislation authorized \$250 million per year for matching grants for fiscal years 2005-2009 for 911 improvements. However, if a state or local government used its E-911 taxes, fees or charges for unrelated purposes, it would no longer be eligible for the federal E-911 grant. Following the publication of the final rules for the ENHANCE 911 Act of 2004 on June 5, 2009, grants ranging from \$200,000 to \$5.4 million were awarded to 30 states and territories.²²

On March 10, 2006, the Government Accountability Office (GAO) issued a report on state and local use of funds collected for the purpose of E-911 implementation. The GAO found that several responding states were using the collected E-911 funds for purposes unrelated to the E-911 program, and in some instances had transferred these funds to the state's general fund.²³

During the 110th Congress, the New and Emerging Technologies (NET) 911 Improvement Act (Public Law 110-283) was signed into law on July 23, 2008.²⁴ The NET 911 Act promotes public safety by encouraging states to deploy a national IP-enabled emergency network and improve 911 services for the disabled. To address the findings of the GAO report, the NET 911 Act also required an annual report to Congress by the FCC on the use of funds set aside by states for E-911 services.

In its third annual report issued on November 8, 2011, the FCC announced that seven states were still diverting funds for uses other than the

²¹ 9/11 Commission Report, <http://www.9-11commission.gov/report/911Report.pdf>.

²² Department of Transportation, National Highway Traffic Safety Administration, Department of Commerce, National Telecommunications and Information Administration, 47 CFR Part 400 [Docket No. NHTSA-2008-0142], RIN 2127-AK37, E-911 Grant Program, The Federal Register, Volume 74, No. 107, June 5, 2009, page 26965, http://www.911.gov/pdf/911-Grant_Program_Final_Reg.pdf.

²³ "Telecommunications: States Collection and Use of Funds for Wireless Enhanced 911 Services," U.S. Government Accountability Office, GAO-06-338, March 10, 2006, <http://www.gao.gov/assets/250/249205.pdf>.

²⁴ William Jackson, "Senate passes NET 911 Improvement Act," *Washington Technology*, June 18, 2008, <http://washingtontechnology.com/articles/2008/06/18/senate-passes-net-911-improvement-act.aspx>.

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original intent.²⁵ While this was a reduction from 11 states in 2009 and 12 states in 2008, five of these states (Arizona, Illinois, Oregon, Rhode Island, and Virginia) were previous offenders, diverting more than \$27.9 million from the E-911 funds. Typically, these diversions have gone into the state's general fund to meet budgetary demands and shortfalls.

On January 14, 2013, the FCC released its fourth annual report, which stated that of the 47 states and two territories that provided information for the report, 45 states and Puerto Rico submitted information that indicated they used collected 911/E-911 funds exclusively for 911/E-911 purposes.²⁶ Louisiana, New Hampshire, Rhode Island, the District of Columbia, the Northern Marianas, and the U.S. Virgin Islands did not respond to the FCC requests. Arizona used \$2.2 million to help close a shortfall in the general fund, while Georgia collected \$13.7 million in pre-paid 911 fees, none of which was allocated for 911/E-911 use. Guam appropriated \$486,323 of its 911/E-911 fee collections for other public safety-related issues, such as leasing ambulances and maintaining the territory's public safety radio communications system. Illinois diverted \$2.9 million into its general fund in FY 2012, and \$6.6 million in FY 2011, but has returned \$1.4 million, with the remainder to be returned to the 911/E-911 fund by September 2012. Maine transferred \$24,568 to its general fund for personnel service reduction initiatives and New York diverted \$22.8 million to its general fund in FY 2011/2012.²⁷

On April 18, 2013, GAO issued another report indicating that most states are now using the funds for the purposes for which they were intended; however, the FCC needs to follow best practices for data collection and analysis in order to improve the collection and reporting of information on state 911 funds.²⁸

The telecommunications industry is one of the most heavily taxed industries in the nation; most of these taxes and fees, including the E-911

²⁵ Public Safety and Homeland Security Bureau Seeks Comment on Information Collection and Recommendations to Congress Regarding State 911/E-911 Fees and Expenditures, PS Docket No. 09-14, Federal Communications Commission, November 8, 2011, <http://www.fcc.gov/document/net-911-e911-911-fees-information-collection>.

²⁶ "Report To Congress on State Collection and Distribution of 911 and Enhanced 911 Fees and Charges," Federal Communications Commission, Submitted Pursuant to Public Law 110-283, December 21, 2012, <http://www.fcc.gov/document/annual-report-state-collection-and-distribution-911e911-fees>.

²⁷ Ibid.

²⁸ "911 Services: Most States Used 911 Funds for Intended Purposes, but FCC Could Improve Its Reporting on States Use of Funds," U.S. Government Accountability Office, GAO-13-376, April 18, 2013, <http://www.gao.gov/assets/660/653929.pdf>.

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fee, are passed along to subscribers. Redirecting the E-911 resources for other uses is a disservice to both taxpayers and subscribers. While progress has been made to reducing the number of states raiding the 911/E-911 funds, a few states continue to rely on these funds to reduce the strains on their general budgets. By raiding these funds, states are reducing the available funds that could be used to improve and update 911 systems in their communities, which could seriously delay help from emergency responders when such needs arise.

THE WHAT, WHERE, AND WHEN OF DIGITAL GOODS TAXES

Digital goods can range from music and videos to mobile apps that can, among other things, create grocery lists, communicate with friends through social media, take improved quality photos on wireless devices, and access news and information. A 2012 report by the Recording Industry Association of America profiling the music consumer found that digital music buyers now constitute 44 percent of men and 54 percent of women.²⁹

As state and local government leaders seek new avenues to increase their revenue streams, the digital goods marketplace is becoming an increasingly attractive target. A number of bills have been introduced in state legislatures to subject these products and services, such as movies, books, ringtones, audio and video works, and similar downloadable products, to sales and use tax.

There are currently 13 states that tax digital goods by statute: Indiana, Kentucky, Mississippi, Nebraska, New Jersey, North Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, Wisconsin, and Wyoming. Alabama, Arizona, Colorado, Connecticut, Idaho, Louisiana, Maine, New Mexico, Texas, and the District of Columbia tax digital goods by administrative rule.³⁰ There are no federal or state guidelines to define the source of digital products sold in interstate commerce, which could lead to consumers being taxed twice for the same transaction should they purchase a digital good, such as a song or ebook in another state. Legislation is currently

²⁹ "Music Consumer Profile—2012," The NPD Group/2012 Annual Music Study, Recording Industry Association of America, May 2013, <http://76.74.24.142/55C8603E-3B67-7A3F-6C11-715EA3870C70.pdf>.

³⁰ "Digital Goods Taxability as of 2013," MyWireless Info Chart, June 3, 2013, <http://www.mywireless.org/federal-issues/digital-goods/>.

THE TAXING PROBLEM OF INTERNET TAXATION

moving through the Minnesota legislature that would redefine “tangible goods” to include digital goods, subjecting those goods to taxation.³¹ The rules regarding the taxation of digital goods purchases can be confusing, but they should certainly not be subjected to multiple and discriminatory taxes.

On July 25, 2013, Sens. Ron Wyden (D-Ore.) and John Thune (R-S.D.) introduced S. 1364, the “Digital Goods and Services Tax Fairness Act,” to establish a national framework for the growing digital marketplace so that digital goods and services would be fairly taxed at the state and local levels. This bill would prohibit a state or local jurisdiction from imposing multiple or discriminatory taxes on sales or use of digital goods or services. It would also eliminate tax-related burdens on interstate commerce that could stifle the vital online market, and prevent consumers from being punished with double or even triple taxes on mp3s, videos, or the latest app, while clearly establishing which jurisdiction (the consumer’s home billing address, for example) has the right to tax digital transactions.

As the digital goods marketplace continues to grow and expand, it is critical to provide clarity to the tax laws that govern these goods and services, and to protect consumers from discriminatory or excessive taxes that would harm this growing industry.

³¹ S.F. 35, a bill for an act relating to taxation; sales and use; reducing the sales and use tax rate; taxing digital products; amending Minnesota Statutes 2012, sections 297A.61, subdivisions 3, 10, 24, by adding subdivisions; 297A.62, subdivision 1, Posted February 8, 2013, <https://www.revisor.mn.gov/bills/text.php?session=ls88&number=SF35&version=list>.