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President Signs Seven-Year Extension of Internet Tax Moratorium

Overview
On October 31, 2007, President Bush signed a seven-year extension of the moratorium on state and local Internet access taxes scheduled to expire on November 1, 2007. Despite support to make it permanent, the moratorium is once again temporarily extended, similar to its previous renewals in 2001 and 2004.

The moratorium on state and local Internet access taxes was originally enacted on October 21, 1998 by President Clinton. It prohibits state and local taxes on Internet access, discriminatory Internet-only taxes (e.g., bit taxes, bandwidth taxes) and multiple taxes on electronic commerce. A common misconception is the moratorium exempts sales made on the Internet. Sales made over the Internet are taxed, however, in the same manner as non-Internet sales akin to mail order sales.

The most recent extension, the Internet Tax Freedom Act Amendments Act of 2007 (H.R. 3678), makes changes to a few provisions of the previous legislation.

First, the current legislation includes an exception to the "grandfathering provisions" contained in the original moratorium. The grandfather clause permits Internet access taxes generally imposed and enforced prior to October 1998. The exception is the grandfather clause will not apply to a state tax on Internet access that was repealed more than 24 months prior to the enactment of the current legislation.

Second, state and local government imposing a tax on telecommunications service purchased, used, or sold by a provider of Internet access are required to end such taxes by June 30, 2008. In conjunction with this change, a new definition of Internet access is enacted. Internet access now means services that enable users to connect to the Internet to access content, information, or other services. Internet access also includes the purchase, use, or sale of telecommunications service by an Internet Service Provider ("ISP") to connect customers to the Internet (i.e., "backbone" services). These two changes are intended to end state and local taxation of Internet backbone service. States such as Alabama, Florida, Illinois, and Pennsylvania currently tax backbone services and will lose revenue as a result of the current legislation.

Third, services incidental to backbone services (e.g., home pages, electronic mail, instant messaging, video clips, personal electronic storage capacity) are included in the new definition of Internet access. As a result, such services may not be taxed by state and local government. The definition of Internet access does not include, however, voice, audio, or video programming, or other products and services provided by ISPs for which there is a charge, regardless of whether or not those charges are bundled

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with charges for Internet access.
Finally, the current legislation clarifies application of the moratorium to state general business taxes, such as gross receipts taxes. The moratorium does not apply to those types of taxes when structured in such a way as to substitute or supplement a state's corporate income tax. As a result, receipts received by ISPs may still be taxed by the Michigan business tax, Ohio commercial activity tax, Texas margin tax and Washington business and occupation ("B&O") tax.

Action Items

GBQ SALT professionals are available to assist you in understanding the applicability of the current
extension of the Internet tax moratorium.

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Action Items

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For more information, please contact:

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