



State of Wisconsin • DEPARTMENT OF REVENUE

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Jim Doyle
Governor

Michael L. Morgan
Secretary of Revenue

Assembly Committee on Ways and Means Hearing, September 17, 2003

AB 234 - Exempting Internet Access Services from Sales and Use Tax – Representative Jensen +12 /Senator Leibham +4

Description of Current Law and Proposed Change

Under current law, Internet access is a telecommunications service and, therefore, subject to sales and use tax. The bill defines the terms "Internet" and "Internet access service" and exempts Internet access service from sales and use tax as of July 1, 2005.

The proposed federal Internet Tax Nondiscrimination Act would prohibit Wisconsin from imposing sales taxes on Internet access after October 31, 2006. If the federal legislation is enacted, AB 234 will be moot.

Fairness/Tax Equity

- AB 234 singles out Internet access from other telecommunications services for preferential tax treatment. Protection from taxation may be necessary to avoid inhibiting the growth of the Internet and e-commerce. However, the Internet is well established and e-commerce is a mature form of business activity.
- The exemption under the bill narrows the tax base and, thereby, shifts more of the costs of government to other taxpayers. Moreover, since the American economy is increasingly based on the production and sale of services and less on goods, the exemption under the bill raises the issue of whether tax revenues will be sufficient to meet the costs of government. Regardless of the level or size of government, exempting growing sectors places more of the tax burden on older industries, which may be inadequate to fund public services.
- Sales taxes on Internet access typically are passed through to end users of the service, thereby avoiding double taxation and minimizing distortion of economic activity.

Impact on Economic Development

- To the extent the cost of Internet access service decreases under the bill, sales of Internet access service are expected to increase. In response, Internet access providers are expected to invest additional capital to meet the increased demand. However, it is not clear whether the tax reduction under the bill would be necessary to increase demand and stimulate investment. For example, Verizon recently announced that it would invest billions of dollars to run fiber optic cable to all of its end users to provide high-speed, high-capacity service throughout its service territories.
- The exemption under the bill would reduce the cost of Internet access, thereby making it more affordable to low-income households. Basic Internet access can be purchased for

about \$10 per month; at the state's highest sales tax rate of 5.6% in Milwaukee, Ozaukee and Washington counties, the sales tax would be \$0.56 per month or \$6.72 per year.

- A University of Tennessee study [1] found no empirical evidence that taxes have deterred access to the Internet. Also, a February 2002 National Telecommunications Infrastructure Administration report indicated that 57% of Wisconsin's population used the Internet compared with 54% of the US population.

Administrative Impact/Fiscal Effect

- Telecommunications services are increasingly bundled by providers offering a package of, for example, local and long distance calling, and Internet access for a single price. Also, these services often are not based on usage and are provided over the same wires and using much of the same equipment. Exempting Internet access, while continuing to tax other telecommunications services, may increase administrative costs of the Department, compliance costs of taxpayers, and the legal costs for all parties to settle disputes regarding what is taxable.
- Currently, the Department estimates that about 50% of Internet access charges are subject to sales tax. However, the rate of compliance is expected to increase as negotiations with service providers are completed. In addition, audits of taxpayers generally improve compliance with the law, both by taxpayers that are audited and those that are not. The fiscal estimate of the bill assumes compliance will have increased to 80% by FY06.

AB 234 is estimated to decrease state sales taxes by about \$34.1 million and county and stadium district sales taxes by about \$2.6 million in FY06. The revenue decreases were estimated twice: First by allocating to Wisconsin a portion of nationwide Internet access revenues reported by the US Bureau of the Census, and second by applying prices to the numbers of Wisconsin dial-up and high-speed Internet access users reported by the Federal Communications Commission. The estimated fiscal effect is the average of the 2 approaches.

- To the extent telecommunications companies allocate more of the cost of a package of services to Internet access and less to taxable telecommunications, the revenue decrease would be larger.

DOR Position

- No position.

Prepared by: Blair P. Kruger, (608) 266-1310

September 12, 2003

[1] "Has Internet Access Taxation Affected Internet Use? A Panel Data Analysis," by Donald Bruce, John Deskins and William F. Fox, November 2002.

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Oral Presentation of Shawn M. Cox

Assistant General Counsel, Tax of America Online, Inc.

Wisconsin Assembly Ways and Means Committee

September 17, 2003

Mr. Chairman Lehman and Members of the Assembly Ways and Means Committee, thank you for inviting America Online, Inc. to provide its perspective on AB 234. Thanks also to Representative Jensen for authoring this legislation, as well as its sponsors for championing it. AOL strongly supports enactment of this legislation to exempt Internet access from Wisconsin sales and use taxes.

AOL's Experience

Since 1985, AOL has been the leader in providing content and Internet access. AOL now has over twenty-five million members in the United States. Our experience in this field has taught us several things about our industry and our members.

First, Internet access technologies are still changing continuously.

Second, broadband rollout remains critical to the expansion of Internet access.

Third, like the rest of the nation, about half of all Wisconsinites currently do not have access to the Internet. These folks tend to be disproportionately poor, less educated, elderly, minorities, or rural. Several factors will play a critical role in reaching this remaining 50 percent: technological enhancements, keeping online services and Internet access affordable for average consumers, and constant upgrading of basic services to make each person's online experience more useful.

Tax policy in states such as Wisconsin will directly impact our industry's ability to achieve these objectives.

History of Taxes on Internet Access

The mid-1990s witnessed a major increase in individual home use of the Internet. Thereafter, the Wisconsin Department of Revenue took the position that the state's tax on telecommunications included Internet access. The Wisconsin Statutes themselves do not expressly provide for a tax on Internet access.

While most states made the policy choice not to tax Internet access – essentially declining to put a toll charge to the information superhighway – the departments of revenue in a handful of other states rushed to tax Internet service providers using laws designed for other industries, resulting in a patchwork of

inconsistent and unclear tax laws. These state and local taxes carried with them price increases for consumers and the cost and uncertainty of tax compliance for business.

Then, in 1998, Congress passed the Internet Tax Freedom Act to halt the proliferation of state and local taxes on Internet access. The Act included an exception for “grandfathered” state and local taxes that were generally imposed and actually enforced as of October 1, 1998 – meaning that the tax was authorized by statute, and either the department of revenue had notified ISPs of the tax, or such taxes were generally collected. The Wisconsin Department of Revenue takes the position that Wisconsin is such a “grandfathered” state.

However, many other states that considered themselves grandfathered under the federal Act have on their own initiative repealed or curtailed their taxes on Internet access. For example, Connecticut, Iowa, and the District of Columbia repealed their taxes on Internet access. South Carolina established its own moratorium corresponding to the federal moratorium. Colorado and Texas have similarly curtailed state and local taxes in this respect. Other states that do not claim to be grandfathered have nonetheless enacted affirmative sales tax exemptions for Internet access – namely, California, New York, Georgia, Kentucky, Massachusetts and Washington.

In the past five years, the federal moratorium has kept most taxes on Internet access in check, and the entire access industry has made great strides toward improving online services, expanding service to more places and increasing the number of people logged on the Internet.

The U.S. Congress voted overwhelmingly in 1998 and 2001 for a moratorium to protect American consumers from onerous state and local tax burdens on Internet access. President Clinton and President Bush supported those bills and signed them into law. The Report of the Congressional Advisory Commission on Electronic Commerce also called upon Congress to make the current moratorium permanent. Now, the House Judiciary Committee has voted to repeal, and the Senate Commerce Committee has voted to sunset, sales taxes on Internet access claimed by these remaining “grandfathered” states coupled with a permanent moratorium.

AB 234

That brings us to today’s hearing and this Committee’s consideration of AB 234 to exempt Internet access from Wisconsin sales and use taxes effective July 1, 2005. AOL sees several advantages in passage of this law:

- First, enactment will promote competition in the industry. High tax compliance costs would disadvantage small and independent Internet service providers, especially in rural areas.

- Second, this legislation will promote innovation in information technologies by permitting Internet service providers to change and expand services without the distorting economic effects of taxation and without diverting funds from R&D to tax compliance.
- Third, AB 234 will also stimulate the Wisconsin economy in general and its technology sector in particular by preventing tax increases on consumers and businesses, promoting Internet access services, and stimulating investment in the industry. Earlier this month Governor Doyle announced his "Grow Wisconsin" initiative for new jobs. One feature of this plan is "to provide universal access to competitively priced broadband for every business and home in Wisconsin in five years." State and local taxes raise the price of Internet access by up to 5.5%, which is at odds with the Governor's growth plan.
- Fourth, this bill will prevent double taxation of Internet access service in addition to taxation of the phone lines people use to access the Internet.
- Fifth, taxes on Internet access raise the cost of Internet access, and disproportionately hurt the 50% of Wisconsinites who still do not have Internet access. According to the U.S. Department of Commerce, of the 2 million households in Wisconsin, 50.2% had Internet access in 2001.
- Sixth, AB 234 promotes innovation in information technologies. According to the Information Technology Association of America (ITAA), taxes on Internet access raise the cost of Internet services (for the providers as well consumers), and thereby suppress demand for broadband and network-enabled innovations at "the edge of the network." ITAA has documented how every dollar invested in broadband use delivers a substantial contribution to the economy in terms of new capital spending, productivity gains, next generation product and service development, new business models and entrepreneurial opportunities, and employment.
- Lastly, it resonates with tax policy embraced by both the federal government and explicitly or implicitly by the great majority of states.

Conclusion

In closing, AB 234 reflects tax policy that promotes productivity, economic growth, technological innovation and the empowerment of individual people to improve the quality of their lives. AOL, on behalf of its customers and its industry, respectfully asks you to enact AB 234 into law.

Thank you.

-end-

Coalition For **Internet Access Tax Exemption**

As representatives of numerous public and private sector industries, tourism and economic growth industries, as well as consumers and taxpayers in the State of Wisconsin, we the undersigned support Assembly Bill 234 which exempts internet access from the sales and use tax.

The internet has become a necessary part of our everyday lives, as businesses and consumers. The internet provides citizens everywhere access to valuable information and government services. As such, Wisconsin should be a state that embraces the internet and send the message to citizens of our state and this country that we encourage the use of the internet for individual prosperity and total economic growth.

While the federal government debates making the internet access tax moratorium permanent, as well as preventing individual states from collecting the tax, we believe Wisconsin should send a strong message to the federal government that we are a business friendly state and ready to grow all sectors of our economy by supporting a sales tax exemption on internet access.

Sincerely,

CenturyTel
Independent Business Association of Wisconsin
Metropolitan Milwaukee Association of Commerce
SBC
TDS Telecom
Verizon
Wisconsin Cable Communications Association
Wisconsin Grocers Association
Wisconsin Innkeepers Association
Wisconsin Manufacturers & Commerce
Wisconsin Merchants Association
Wisconsin Realtors Association
Wisconsin State Telecommunications Association
Wisconsin Technology Network

MEMORANDUM

TO: Honorable Members of the Assembly Committee on Ways and Means

FROM: Allison Bussler, ^{AB} Senior Legislative Associate

DATE: September 17, 2003

RE: Opposition to Assembly Bill 234

The Wisconsin Counties Association opposes Assembly Bill 234. AB 234 creates a sales and use tax exemption for Internet access services.

It is estimated that local government sales taxes would decrease by about \$2.4 million in FY04 and \$2.9 million in FY05 under AB 234.

Currently, Wisconsin's counties have the option of implementing a county sales tax of 0.5%. Each sales tax exemption results in decreased revenue to the state and to the fifty-seven counties who have in place a county option sales tax. (On January 1, 2004 Wood County will also start collecting a county sales tax.) Revenue derived from the imposition of a county option sales tax reduces the reliance on property tax revenues to fund county services and state mandates. Additionally, with counties subjected to a tax rate limit, counties cannot afford to lose revenue in any form. Thus, any new sales tax exemption decreases county revenue that increases reliance on the property tax that could lead to cuts in county-provided services.

Counties are currently in the process of putting their budgets together for next year and are grappling with a reduction in several state funding programs such as shared revenue, community aids, the local bridge program and the surface transportation urban and rural programs. Reducing state aids and reducing sales tax revenue makes it very difficult for counties to "freeze" their tax levies.

Any reduction in county sales tax revenue has a direct effect on the services counties provide. As the cost of providing services to Wisconsin citizens continues to rise, tax exemptions require close examination. The Wisconsin Counties Association respectfully requests your opposition to Assembly Bill 234.

Thank you for considering our comments.

Halverson, Vicky

From: Gates-Hendrix, Sherrie
Sent: Friday, September 19, 2003 2:52 PM
To: Rep. LehmanM
Cc: Ford, William; Halverson, Vicky; Helgerson, Jason
Subject: Follow-up Info on AB 234 - Internet Access

Rep. Lehman --

At the Ways & Means hearing on AB 234 (9/17/03) you asked if DOR could provide information on what percentage of the population uses the Internet in other states. The attachment reproduces a table showing internet use by state as of September 2001. For comparison sake, states that taxed Internet access as of September 2001 are bolded. The table is taken from the February 2002 US Department of Commerce, National Telecommunications and Information Administration report, *A Nation Online: How Americans Are Expanding Their Use of the Internet*.



Internet use table
1-1.xls

Our sales tax research analyst also provided me with this study, which specifically addresses the effect of taxes on internet access.



Effect of taxes on
internet ac...

I hope this is helpful. Please let me know if you have any questions or need more information.

Sherrie Gates-Hendrix
DOR Legislative Liaison
267-1262

U.S. DEPARTMENT OF COMMERCE
 Economics and Statistics Administration
 National Telecommunications and Information Administration

A NATION ONLINE: How Americans Are Expanding Their Use of the Internet, February 2002

Table 1-1. Internet Use by Percent of State Population [as of September 2001]

	State Total Population, Age 3+ (Thousands)	Internet Users (90 Percent Confidence Interval)*	Notes
United States	265,180	53.6—54.1	
Alabama	4,271	43.3—49	
Alaska	593	66—71.6	
Arizona	4,641	50.4—55.8	
Arkansas	2,544	41.4—47.1	
California	33,108	50.9—53.3	
Colorado	4,004	57.3—62.9	
Connecticut	3,170	55.3—61.9	Repealed tax July 2001
District of Columbia	509	42—48.6	
Delaware	732	55.1—61.6	
Florida	15,075	50.5—53.5	
Georgia	7,550	47.7—52.8	
Hawaii	1,150	47.6—54.1	
Idaho	1,244	53—58.5	
Illinois	11,486	49.5—53	
Indiana	5,733	52.6—58.4	
Iowa	2,769	55.3—61.2	
Kansas	2,509	55—61	
Kentucky	3,785	50.3—56.1	
Louisiana	4,141	40.6—46.2	
Maine	1,233	57.2—63.6	
Maryland	5,115	58.4—64.3	
Massachusetts	5,993	54.5—58.8	
Michigan	9,553	54.6—58.2	
Minnesota	4,742	60.7—66.2	
Mississippi	2,642	38.9—44.7	
Missouri	5,192	54.3—60.3	
Montana	866	54.7—60.4	
Nebraska	1,632	52.4—58.4	
Nevada	1,902	49.2—54.9	
New Hampshire	1,194	60.2—66.7	
New Jersey	7,944	58.1—61.8	
New Mexico	1,754	46.9—52.6	
New York	17,510	51.6—54.3	
North Carolina	7,200	45—49.3	
North Dakota	591	53.4—59.5	
Ohio	10,877	53.2—56.8	
Oklahoma	3,161	46.8—52.5	

Oregon	3,358	58.2—64.1
Pennsylvania	11,356	53.3—56.7
Rhode Island	943	53.3—60
South Carolina	3,728	44.6—50.7
South Dakota	690	55.9—61.6
Tennessee	5,209	49.5—55.5
Texas	19,576	49.7—52.6
Utah	2,061	58.7—64
Vermont	590	57.3—63.6
Virginia	6,653	55.7—61.2
Washington	5,661	58.3—64.2
West Virginia	1,712	43.9—49.5
Wisconsin	5,070	54.1—59.9
Wyoming	460	59.3—65.2

Texas exempts the first
 \$25 each month
 of internet access
 charges

* Specific point estimates are subject to sampling error (see Methodology Section). This Table reports the 90 percent confidence interval to avoid inaccurate and misleading rankings of states by Internet use point estimates. With a probability of 90 percent the "true" percent of Internet use falls within this range.

Has Internet Access Taxation Affected Internet Use?

A Panel Data Analysis

Donald Bruce, John Deskins, and William F. Fox*

University of Tennessee

November 2002

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*Corresponding author. The authors thank participants at the 2002 National Tax Association Annual Conference on Taxation and the University of Tennessee Department of Economics Brown Bag Research Workshop for insightful comments on an earlier draft.

Has Internet Access Taxation Affected Internet Use?

A Panel Data Analysis

ABSTRACT: Most arguments in favor of the Internet Tax Freedom Act (ITFA) assume that taxing Internet access would reduce Internet use. We investigate this possibility empirically, making use of panel data covering all U.S. states for the years 1998, 2000, and 2001. Statutory variation in the taxation of Internet access occurs because ten states were permitted to continue their existing Internet access taxes as of the initial passage of the ITFA in 1998. None of the econometric analyses provides any evidence that Internet access taxes have had an effect on Internet access rates.

JEL Codes: H2, H7

I. Introduction

The October 1998 Internet Tax Freedom Act (ITFA) originally placed a three-year moratorium on the taxation of Internet access and other discriminatory taxation directed toward the Internet. In other words, states were prohibited from levying new taxes on Internet access charges or discriminatory taxes on sales of goods and services over the Internet. The moratorium was extended for two years in November 2001 and is set to expire in November 2003.

Proponents of ITFA argue that taxation of the Internet, among other reasons, will hinder the growth of the information revolution and will limit individuals' abilities to gather knowledge efficiently. Fundamentally, most arguments in favor of such a policy assume that a tax on Internet access would reduce the number of people who use the Internet. However, no empirical support has been provided for this assertion.

In this paper we empirically examine the relationship between Internet access and taxation. Using a three-year panel of data from every US state and a variety of econometric techniques, we find no empirical evidence that internet access rates are lower in states that have levied a tax on Internet access, all else equal. We begin by providing a review of the various arguments for and against Internet access taxation. Next we present an overview of the current state of Internet access taxation in the United States. Lastly, we discuss our statistical procedures and findings.

II. Should Internet Access Be Taxed?

Most arguments favoring a ban on taxation of Internet access stem from the perception that taxation will deter Internet access. This argument seems consistent with elementary microeconomic theory in the most basic framework. If a tax is levied on Internet access, it will raise the price paid by consumers and/or lower the price retained by producers, which will in turn reduce the quantity of Internet access demanded. However, if demand and/or supply are sufficiently inelastic with respect to price, or if the price change is quantitatively small, the effect of a tax on Internet access may be small enough to go unnoticed. As such, this is inherently an empirical question.

Proponents of the ITFA usually assume (perhaps implicitly) that the quantity of Internet access will respond significantly to a (tax induced) price change. The fear is that access to information will be limited, thereby dampening the growth of the Information Revolution, and decreasing the number of transactions made over the Internet. Certainly a ban on Internet access taxation may be warranted in this scenario if fostering the growth of the Internet is desirable and if we assume that Internet connection rates would respond significantly to taxation. This line of reasoning is strengthened if the Internet is still in its infancy and fast growth is attainable. However, data suggest that the Internet has grown rapidly past what many would consider “infancy” (US Department of Commerce, 2002).

Another argument in favor of a ban on access taxation relates to a “digital divide” in the United States. That is, the Internet and other information technologies are more prevalent among the wealthier population than among lower income individuals (US Department of Commerce, 1999). The Department of Commerce reported that this gap was widening in the mid- to late 1990’s and it seemed likely that, if taxation reduced Internet connection rates, the lowest income

individuals would be the first to forgo the Internet. This would further widen the digital divide. However, more recent studies have shown that the digital divide has lessened in the past few years and that the Internet is becoming almost as prevalent among lower income households as among wealthier households (US Department of Commerce, 2002).

Some proponents have argued in favor of a ban on Internet access taxation on the basis of network externalities. This is the notion that consumer benefits increase as the number of consumers rises. Therefore, to fully take advantage of network effects, we should avoid discouraging Internet connection rates by taxing Internet access (again, assuming that consumers are responsive to taxation). This is similar to the classic example of a positive externality, wherein efficiency would call for subsidization (or exemption from taxation) of the good that generates the positive externality. Zodrow (2000) examines the question of network effects and concludes that arguments for preferential treatment of the Internet on these grounds are weak, and that a complete tax exemption of the Internet would be inappropriate even if network externalities were assumed to exist.¹

Another argument in favor of a ban on Internet access taxation relates to the perceived difficulty that multi-state firms would have in collecting taxes for many state and local governments. The presumption is that it would be very costly for a firm serving multiple states to collect access taxes for every customer it serves, given the widely different tax structures and rates across state and local governments. A similar presumption was a primary reason why the U.S. Supreme Court ruled in the *Quill* case that multi-state firms could not be required to collect sales taxes on purchases by customers who are not located within a state in which the firm has

¹ Goolsbee and Zittrain (1999) also address these issues.

physical presence.² This concern does not apply to local Internet providers that only operate in one state.

Conversely, those opposing the ban on Internet access taxation generally believe that Internet connection rates would be relatively unresponsive to taxation. Classical optimal tax theory suggests that taxing relatively inelastic goods at higher rates would minimize the total deadweight loss of taxation (Diamond and Mirrlees, 1971). Therefore, if Internet access was relatively inelastic, efficiency would call for relatively high taxation of it— the polar opposite of a ban on taxation. Another argument against the ban is that states need revenue and broadening the sales tax base can be an appropriate way to achieve this goal. Internet access is simply another good that can be taxed to generate revenue for states that are in budget crises.³

Mazerov and Lav (1998) discuss arguments that states should not unfairly target Internet services, pointing out that none of the states that tax Internet access actually enumerated it for taxation. Instead, Internet access has fit within the definition of taxable transactions under current state taxation of telecommunications, electronic information or other services. Mazerov and Lav argue that this indicates Internet access taxes have certainly not been unfairly directed toward the Internet. Further, they state that “In some instances these determinations were issued at the request of Internet service providers seeking guidance on their obligation to charge taxes on their services” (Mazerov and Lav, 1998).⁴ They go on to note that the Internet can be a substitute for many services that are already taxable. For example, the Internet can be used to make long distance telephone calls, send faxes, download online magazines, etc., all of which would normally be taxable in many states.

² *Quill v. North Dakota*, 112 U.S. 298 (1992).

³ See Mazerov and Lav (1998) and Mazerov (2001) for more about the revenue consequences of a tax exemption of Internet access and other revenue implications of the ITFA.

⁴ This source may be viewed online at <http://www.cbpp.org/512webtax.htm>.

A key concern with a permanent ban on Internet access taxation is that companies can bundle Internet access with other telecommunications services, and label the entire bundle “Internet access” to escape taxation altogether. That is, a company could sell Internet access, telephone services, cable television, and/or other telecommunication goods, all in one bundle and avoid all taxation on the sale. Another possibility is that a firm could sell “digitized content” over the Internet, i.e. downloads of music, video, etc., and, due to unclear wording, the entire package could be deemed “Internet access” and the music and video could escape taxation.⁵

III. Internet Access Taxation in the US

The ITFA only permits imposition of a tax on Internet access by those ten states that were already doing so at the time of ITFA’s initial passage by Congress in 1998. Seven of those original ten states continue to tax Internet access while three have subsequently dropped the tax voluntarily. Table 1 summarizes the current status of Internet access taxation in these ten states. In all cases, the taxation of Internet access occurs through existing state tax legislation as no state has specifically introduced an “Internet Access Tax.” For example, New Mexico taxes Internet access charges through its gross receipts tax while Tennessee levies the tax through a telecommunications service tax (Wright, 1998). Little data are available to analyze the receipts from taxing Internet access. Data from Tennessee suggest the revenue implications to-date are relatively small, perhaps less than \$5 million.⁶

One complication surrounding Internet access taxation is that interstate firms can only be required to collect taxes on sales of Internet access to consumers in states where the firms have

⁵ See Mazerov (2001) for a discussion.

⁶ Separating the revenue associated with taxation of Internet access from that arising from other taxable transactions is very difficult because the same vendor may be involved in the provision of Internet access and other taxable activities.

nexus. The minimum physical presence necessary for online service providers to have nexus is yet to be determined and is currently being addressed in the courts. America Online, which is based in Virginia, was provided a summary judgment by the trial Court in a Tennessee nexus case, but the Court of Appeals recently ruled that the trial court did not have sufficient information to reach a summary judgment ruling. As such, the case has been remanded to the trial court for further proceedings. Any effect that Internet access taxes may have on Internet access rates would likely be dampened by court rulings that limit a state's ability to require firms to collect the tax. Also, many Internet access purchasers actually buy from smaller, single-state firms. Therefore, Internet access taxes could potentially affect Internet connection rates.

IV. Does Internet Access Taxation Affect Internet Access?

Ten states have imposed a tax on Internet access for at least one year, while the other states (including the 35 others that impose a general sales tax) have not, providing an excellent opportunity to examine what effect, if any, Internet access taxation has on Internet connection rates. The effect of Internet access taxation is analyzed by comparing Internet connection rates between the taxing and non-taxing states. The finding of a significant difference in Internet connection rates between the two groups of states, holding all other determinants of Internet access equal, would lead to the conclusion that Internet access taxation has affected Internet connection rates within the United States during the timeframe of our analysis.

The empirical analysis is carried out using a three-year discontinuous panel of data representing every US state. The data set includes the percentage of households in a state that are connected to the Internet and the percentage that own a computer for 1998, 2000 and 2001 (U.S. Department of Commerce various years). Similar data are not available for 1999.

The primary goal is to examine the effect that Internet access taxation has had on Internet access rates. In order to achieve this, we must control for other determinants of Internet access, including some measure of computer ownership. However, to foreshadow the empirical issues encountered in our analysis, computer ownership decisions are likely to be simultaneous with Internet access decisions, leading to familiar endogeneity concerns. A proper multivariate regression analysis would thus require an instrumental variable that explains computer ownership but does not independently influence Internet access. Unfortunately, we were unable to find a sufficiently strong instrument; the close relationship between the two variables makes this difficult.⁷

For this reason, a broader, more disaggregated focus is chosen over an analysis that focuses on Internet access rates exclusively. More specifically, the relationship between Internet access taxes and the following three measures is examined: the Internet access rate (*NET*), the computer ownership rate (*Computer*), and the Internet access rate conditional on computer ownership (*NET/Computer*). This broad focus enables an understanding of any effect of Internet access taxation from a variety of angles, and endogeneity issues can be avoided.

The first step is a simple ranking of the values of these three indicators for all states, where the ranking is based on the average across the three years of data (Table 2). The first ranking shows the percentage of households in each state that is connected to the Internet. States that have taxed Internet access for at least one of the three years are denoted in bold print. With the exception of Connecticut, all of the states that have taxed Internet access charges lie within the lower half of the distribution. The second ranking presents data on computer ownership rates. Here most of the taxing states are still within the lower half although Iowa and Wisconsin

⁷ One possible candidate for an instrumental variable is the presence of a sales tax holiday on computer hardware purchases. However, only two states introduced such a holiday within the timeframe of our analysis. Therefore, it

appear in the upper half. The third column presents the ranking in terms of Internet users as a share of computer owners. Here, two taxing states are within the upper half while the rest are in the lower. These rankings provide weak evidence that a tax on Internet access might have lowered Internet access rates, regardless of whether we condition on computer ownership.

The second step is to compare sample means of the three measures between those states that have taxed Internet access and those that have not, to determine whether a significant difference exists between the two groups of states in terms of access rates, computer ownership rates, and Internet users as a share of computer owners. The means and standard deviation of these variables for the two groups of states are reported below:

Internet Access Rate (NET)

	Mean	Std. Dev.
States that <i>did not</i> levy access taxes	39.75	11.90
States that <i>did</i> levy access taxes	36.96	11.06

Computer Ownership Rate (Computer)

	Mean	Std. Dev.
States that <i>did not</i> levy access taxes	50.77	9.30
States that <i>did</i> levy access taxes	48.45	7.00

Internet Users as a Share of Computer Owners (NET/Computer)

	Mean	Std. Dev.
States that <i>did not</i> levy access taxes	76.78	12.27
States that <i>did</i> levy access taxes	74.68	13.13

All three measures are higher on average in those states that have never taxed Internet access. However the difference is very small in all cases, only around two to three percentage points. In fact, the null hypothesis that the two means are equal cannot be rejected at

proves to be a weak instrument (i.e. it is not a statistically significant determinant of computer ownership).

conventional confidence levels using t-tests. Similar results were found when the figures were examined on a year-by-year basis.

Of course, the above analyses are overly simplistic because they do not account for other factors that affect Internet usage. Multivariate regression analysis is used to correct this deficiency. Three different regression frameworks are used in the analysis, one for each of the above three measures of Internet access or computer ownership. The key independent variable of interest is a dummy variable for whether or not a state levied a tax on Internet access in a given year (*TAX*). *TAX* takes the value of one if a state levied a tax on Internet access for at least one month out of the year and zero otherwise.

Also included in our regression analyses are several commonly used socioeconomic variables that are expected to be important predictors of Internet access rates. Among these are the percentage of a state's residents over the age of 65 (*AGE*), population density (*DENSITY*), per capita personal income (*INCOME*), the poverty rate (*POVERTY*), the percentage of residents that are white (*RACE*), the percentage over age 25 that holds a BA or higher (*SCHOOL*), and the percentage living in an urban area (*URBAN*). A weighted average state and local sales tax rate for each state (*RATE*) is also included, as earlier research suggests that individuals are significantly more likely to shop online when their sales tax rate is higher (Goolsbee, 2000). Table 3 provides a brief summary of all regression variables as well as their sources, and Table 4 provides summary statistics. Three years of data are used for 50 states, providing a sample size of 150.

A panel regression model with random effects for the cross sectional units is used in the analysis. To further control for potential endogeneity, all independent variables are lagged one period.⁸ The model is specified as follows:

$$NET_{i,t} = \beta_0 + \beta_1 TAX_{i,t-1} + \beta_2 AGE_{i,t-1} + \beta_3 DENSITY_{i,t-1} + \beta_4 INCOME_{i,t-1} + \beta_5 POVERTY_{i,t-1} + \beta_6 RACE_{i,t-1} + \beta_7 RATE_{i,t-1} + \beta_8 SCHOOL_{i,t-1} + \beta_9 URBAN_{i,t-1} + \beta_{10} Year\ 2 + \beta_{11} Year\ 3 + \varepsilon_{it}$$

where i and t are state and year indices, and $\varepsilon_{it} = u_i + w_{it}$. The traditional error term is denoted by w_{it} and is assumed to meet all of the usual requirements, and u_i represents the state-specific random effect. Two dummy variables are included to control for year effects, where *Year 2* represents 2000 and *Year 3* represents 2001. To test the findings of this specification, the analysis is repeated by replacing *NET* with *Computer* and *Net/Computer*. The results of these regressions are presented in Table 5.

Beginning with the first column of results, *TAX* does not have a statistically significant effect on Internet access rates, meaning that Internet access taxation has not deterred Internet usage.⁹ The rest of the regression is a good fit, as the overall R^2 indicates that the model is explaining the vast majority of the variation in *NET*. However, the random state effects explain around 67 percent of the variation. This indicates that other quantifiable and non-quantifiable effects that differ by states are very important determinants of Internet access. In addition, we find that the year effects have a large amount of predictive power with access growing over time.

Income is a strong determinant of Internet access rates with access rates rising about 0.75 percentage points for each \$1,000 increase in real state personal income per person, all else

⁸ This further complicated the ability to adequately control for computer ownership, because computer ownership data could only be obtained for the same three years for which Internet access data are available. All other regression variables were available for all "lag" years.

⁹ An alternative partial explanation is that states are unable to effectively enforce the tax, either because of difficulties in identifying service providers or because some Internet Service Providers assert that no taxable nexus exists. For example, Tennessee estimates that there are 750 Internet service providers in the State, creating

equal. In addition, states with smaller minority populations, more education, and younger populations have higher Internet connection rates. Interestingly, states with higher sales tax rates have lower Internet connection rates, *ceteris paribus*.

To be sure, this specification suffers from the inability to control for computer ownership. It may be the case that these factors influence computer ownership rates but have no independent effect on Internet access rates. This possibility is addressed in the second specification, where the computer ownership rate is the dependent variable. Corresponding to the earlier results, this model finds that Internet access taxation is not a statistically significant determinant of computer ownership rates, thus adding support to the previous finding that *TAX* has no statistically distinguishable effect on *NET*. This model also has strong explanatory power given the overall R^2 of 0.85. However, as with the above model, the random state effects explain most of this variation. Likewise, year effects also have strong explanatory power. Strangely, income is not a significant determinant of computer ownership rates though states with more people living in poverty have lower computer ownership rates. Also, other demographic characteristics including having a more urban, non-minority, or more educated population positively influence computer-owning households and states with older populations have lower ownership, all else equal. Finally, a higher sales tax rate translates into a lower computer ownership rate. This suggests that the price effect of high sales tax rates discourages computer ownership.

The results from the first two specifications indicate that computer ownership is a crucial omitted variable that must be controlled for since the omitted variable bias in the access equation could be large because of the strong relationship between computer ownership and the other independent variables. However, the inability to lag computer ownership in the *NET* regression

significant collection problems. Consumers may see no price effect from imposition of the tax, even in states where the tax is legally due, if the tax is not being broadly collected.

and the more important lack of suitable instrumental variables means that an alternative method must be used to control for computer ownership. This is achieved in the third specification by using *NET/Computer* as the dependent variable. As with the first two specifications, *TAX* is not found to have a statistically significant effect. This model again results in a high predictive power as evidenced by the R^2 estimate, and again the random state effects explain most of this variation.

The importance of conditioning on computer ownership becomes abundantly clear, as characteristics that would likely predict both computer use and Internet independently are no longer significant predictors of the relationship. For example, *AGE*, *RACE*, *SCHOOL*, and *URBAN*, which were significant in at least one of the previous two regressions, are no longer significant once access is conditioned on computer ownership. Instead, per capita income and the sales tax rate are the only statistically significant predictors of the ratio of Internet users to computer owners. Among computer-owning households, higher per capita personal income and lower sales tax rates lead to increased Internet access rates. The negative coefficient on the sales tax rate suggests that people who fail to purchase a computer because of the sales tax are ones who would be particularly likely to go online, so that net access drops relatively faster than computer ownership. Overall, the tax results indicate that sales taxation of computer purchases is the dominant tax feature rather than taxation of Internet access. This is not a surprising result since the taxable base from purchase of a computer can easily represent 100 or more months of Internet access.

A common econometric concern with panel data is whether or not the random effects specification is appropriate. An alternative approach would be a fixed effects specification, where changes in variables within states would drive the empirical results. However, the random

effects approach is preferred because the key variable of interest, *TAX*, does not vary significantly during the period of analysis. Consequently, state fixed effects would likely capture most of the influence of *TAX* on our three dependent variables. Clearly, this would produce a less meaningful result, as the effect of *TAX* would be driven entirely by the three states that repealed their Internet access taxes.

However, despite this preference, the possibility remains that a random effects approach could be econometrically inappropriate if the random effects are correlated with any of the included regressors. A Hausman (1978) test is used to examine whether this correlation exists. The Hausman test leads to rejection of the null hypothesis that the error term and regressors are correlated under the first specification (with *NET* as the dependent variable) and to rejection of the null hypothesis at a marginal level of significance under the second specification (with *Computer*). The null hypothesis cannot be rejected under the third model. Nonetheless, we accept this potential bias and place our reliance on the random effects models because of the inappropriateness of the fixed effects framework. Furthermore, even in the fixed effects models, *TAX* was never found to have a statistically significant effect on any of our three dependent variables.¹⁰

The main findings are tested further in several other ways. First, regressions are performed without any panel effects (i.e., with neither fixed nor random effects). The analyses are also conducted in a year-by-year framework, running separate Ordinary Least Squares (OLS) regressions for each of the three years of data. Finally, the focus is shifted from the levels of *NET*, *Computer* and *NET/Computer* in each year to their growth rates. The growth rates from 1998 to 2001 are calculated for each of the variables, and then regressed on the 1998 values of the set of independent variables used in Table 5. The overarching conclusion from all of these

checks is that Internet access taxation (*TAX*) is never a statistically significant determinant of any of our three dependent variables or their growth rates.

V. Conclusion

This paper attempts to understand whether Internet access taxation has affected Internet usage in any way. The US has provided something of a laboratory for such an experiment given that ten states have taxed Internet access at some point in recent history while the other forty have not. Regression analysis is conducted to compare Internet access, computer ownership, and Internet access conditional on computer ownership, between the taxing and non-taxing states. Results show that Internet access taxation has had no statistically discernible effect on any of these three measures. Further, this general conclusion is found to be robust to a wide variety of econometric specifications.

¹⁰ Full results from this and all other robustness checks are available from the authors upon request.

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Table 1: Status of Internet Access Taxation in Grandfathered States

State	Status of Access Taxation
Connecticut	Dropped tax on access July 2001
Iowa	Dropped tax on access May 2000
Ohio	Currently levy tax on access
New Mexico	Currently levy tax on access
North Dakota	Currently levy tax on access
South Carolina	Dropped tax on access October 1998
South Dakota	Currently levy tax on access
Tennessee	Currently levy tax on access
Texas	First \$25 of access charges exempt as of October 1999
Wisconsin	Currently levy tax on access

Table 2: State Rankings of Key Variables

State	Internet access	State	Computer ownership	State	Internet users as a share of computer owners
Alaska	55	Alaska	65	Connecticut	84
New Hampshire	52	Utah	65	Florida	84
Washington	49	New Hampshire	62	Alaska	83
Colorado	48	Washington	61	New Hampshire	82
Oregon	47	Colorado	61	New Jersey	82
Utah	46	Oregon	59	Massachusetts	81
Connecticut	46	Minnesota	56	Vermont	80
New Jersey	45	Idaho	56	Maryland	80
California	44	California	55	Delaware	79
Maryland	44	Maryland	55	Nevada	79
Vermont	44	New Jersey	55	Washington	79
Massachusetts	43	Connecticut	54	Rhode Island	79
Delaware	43	Vermont	54	Pennsylvania	79
Minnesota	43	Wyoming	54	Georgia	79
Virginia	42	Maine	54	California	79
Hawaii	42	Virginia	53	New York	79
Florida	41	Hawaii	53	Virginia	79
Arizona	41	Delaware	53	Colorado	79
Idaho	41	Arizona	52	Hawaii	78
Maine	41	Kansas	52	Oregon	78
Kansas	40	Massachusetts	52	Arizona	78
Nevada	40	Iowa	51	Ohio	77
Rhode Island	40	Michigan	51	Illinois	77
Michigan	40	Wisconsin	50	Indiana	77
Wyoming	39	Missouri	50	Alabama	76
Missouri	39	Nevada	50	Missouri	76
Ohio	39	Montana	49	Texas	76
Wisconsin	39	Ohio	49	Michigan	76
Pennsylvania	38	Rhode Island	49	Wisconsin	76
New York	38	South Dakota	49	West Virginia	76
Illinois	38	Nebraska	49	Kentucky	76
Indiana	38	Illinois	49	Kansas	75
Iowa	37	Florida	49	North Carolina	75
Texas	37	Indiana	49	Tennessee	75
Montana	37	Texas	48	Oklahoma	74
South Dakota	36	Pennsylvania	47	Maine	74
Georgia	36	New York	47	Minnesota	74
Nebraska	35	North Dakota	47	New Mexico	74
North Dakota	35	New Mexico	47	South Carolina	73
New Mexico	35	Georgia	45	South Dakota	73
Tennessee	34	Tennessee	45	Louisiana	73
Kentucky	34	Kentucky	44	North Dakota	73
North Carolina	33	South Carolina	44	Idaho	72
South Carolina	33	North Carolina	43	Montana	72
Oklahoma	33	Oklahoma	43	Wyoming	71
Alabama	32	Alabama	41	Utah	71
West Virginia	31	West Virginia	40	Nebraska	71
Louisiana	30	Louisiana	39	Iowa	70
Arkansas	26	Arkansas	38	Mississippi	70
Mississippi	25	Mississippi	35	Arkansas	66

Bold indicates those states that have taxed Internet access for at least one year.

Table 3: Variable Descriptions and Sources

NET	Percentage of households in a state that have an Internet connection Dept. of Commerce
Computer	Percentage of households in a state that own a computer Dept. of Commerce
NET/Computer	Households with Internet access as a share of households that own computers Dept. of Commerce
TAX	1 if state levies tax on Internet access for at least one month out of the year, 0 otherwise Authors' calculations
AGE	Percent of people in a state that are over age 65 Statistical Abstract of the United States, Various Years
DENSITY	Population per square mile of land area in a state Statistical Abstract of the United States, Various Years
INCOME	Real state personal income per person, in thousands Bureau of Economic Analysis
POVERTY	Percentage of a state's residents who live below the poverty line Statistical Abstract of the United States, Various Years
RACE	Percentage of a state's residents who are white Statistical Abstract of the United States, Various Years
RATE	State general sales tax rate added to the average county and city rate for the state Sales Tax Clearinghouse (http://www.taxch.com/STRates.stm)
SCHOOL	Percentage of a state's residents, over age 25, that have a Bachelor's degree Statistical Abstract of the United States, Various Years
URBAN	Percentage of a state's residents that live in an urban area Statistical Abstract of the United States, Various Years

Note: All percentages are on a 0-100 scale.

Table 4: Summary Statistics

	Mean	Std. Dev.	Min	Max
NET	39.2	11.8	13.6	64.1
Computer	50.3	8.9	25.7	68.7
NET/Comptuer	76.4	12.4	49.2	94.5
TAX	18.7	39.1	0	1
AGE	12.6	1.9	5.5	18.3
DENSITY	177.1	241.6	1.1	1134.2
INCOME	25.6	3.9	18.5	37.8
POVERTY	11.6	3.2	5.2	21.2
RACE	83.2	12.3	24.3	98.4
RATE	5.7	2.1	0	8.35
SCHOOL	23.6	4.6	13.3	38.7
URBAN	68.1	16.8	27.8	100

Table 5: Random Effects Regression Results

	NET	Computer	NET/Computer
TAX	-0.504 (1.017)	-0.775 (1.100)	-0.583 (1.015)
AGE	-0.0826*** (0.250)	-1.058*** (0.268)	-0.056 (0.241)
DENSITY	-0.003 (0.003)	-0.004 (0.003)	0.002 (0.002)
INCOME	0.747*** (0.183)	0.261 (0.201)	0.687*** (0.193)
POVERTY	-0.156 (0.115)	-0.400*** (0.130)	-0.880 (0.167)
RACE	0.090*** (0.035)	0.153*** (0.038)	-0.009 (0.036)
RATE	-0.871*** (0.214)	-0.915*** (0.230)	-0.411* (0.208)
SCHOOL	0.258*** (0.099)	0.370*** (0.111)	0.002 (0.113)
URBAN	0.026 (0.024)	0.076*** (0.027)	-0.012 (0.028)
Constant	10.94* (6.377)	34.75*** (6.975)	46.3*** (6.676)
Year 2	12.95*** (0.519)	6.60*** (0.586)	18.35*** (0.647)
Year 3	21.77*** (0.593)	12.26*** (0.667)	26.22*** (0.717)
	R ² =0.925	R ² =0.850	R ² =0.928

*, **, *** indicate significance at the 10%, 5%, and 1% levels respectively.
Standard errors in parentheses.

Halverson, Vicky

From: Frank P. Tower [frankt@northnet.net]
Sent: Friday, September 19, 2003 4:49 PM
To: rep.lehmanm@legis.state.wi.us
Subject: Frank Tower Testimony on AB 234 - Supplementary FCC Information

Representative Lehman and members of the committee:

Please find enclosed the requested information from Federal Communications Commission per the request of the committee during the hearing held on 09.17.03 on AB 234.

The first URL:

http://www.fcc.gov/Bureaus/Common_Carrier/Factsheets/nominute.html

Points to a fact sheet about a ruling that was made on the 25th of February, 1999. The important point is under item 4., 'What did the FCC conclude in its February 25, 1999 decision?'. Specifically:

... preserves the rule that exempts the Internet and other information services from ...

Clearly, the FCC is noting that they consider Internet access as an information service.

Additionally, a second URL:

http://ftp.fcc.gov/Bureaus/Cable/News_Releases/2002/nrcb0201.html

Points to the fact that the FCC considers Internet service sent over a cable line to be information. The only difference between cable Internet service and internet service over a telephone line, other than the speed, is the medium used.

If you or any member of the committee would desire additional information, please feel free to contact me.

Thank you.

--
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Fact Sheet

The following fact sheet provides information in response to erroneous reports that the FCC is planning to impose per-minute usage charges on consumer access to Internet Service Providers (ISPs). It also discusses the FCC's February 25, 1999 decision relating to dial-up traffic bound for ISPs. The bottom line is that the FCC has no intention of assessing per-minute charges on Internet traffic or changing the way consumers obtain and pay for access to the Internet.

1. What is the source of this misunderstanding?

The FCC has been considering issues relating to certain carrier-to-carrier payments, so-called "reciprocal compensation." These payments compensate a local telephone company for completing a local call that is placed by one of its competitor's customers. On February 25, 1999, the FCC adopted a Declaratory Ruling regarding these carrier-to-carrier payments and initiated a new proceeding to consider the matter in light of conclusions reached in the Declaratory Ruling. The following is an example of how the carrier-to-carrier payments at issue work:

If a customer of Phone Company A makes a local call to a customer of Phone Company B, Phone Company A must compensate Phone Company B for handling the last leg of the call. This payment structure, called reciprocal compensation, may have been negotiated by the two phone companies, or may be based on a decision of the state regulatory authority. The reciprocal compensation payment by Company A to Company B may be based on a per-minute charge for the length of the call, or some other negotiated basis.

Reciprocal compensation is thus paid between telephone companies for use of the local phone network. Reciprocal compensation is not paid by consumers or by Internet service providers. Accordingly, reciprocal compensation does not determine consumer Internet charges. Typically, the companies involved are an incumbent local telephone company (ILEC) currently serving a large number of subscribers, and a competing local telephone company (CLEC) that has only recently entered the market and has fewer subscribers.

2. So why is this suddenly an issue?

There is a dispute in the telephone industry over whether calls to ISPs are subject to reciprocal compensation, and that is the matter the FCC is considering. In the example above, if the consumer dials up the Internet over the phone lines of Phone Company A, and the ISP is served by Company B, the question is whether Company A must compensate

Company B for delivering the call to the ISP. That is the only issue before the Commission with regard to this matter. Thus, the manner in which consumers pay for Internet access is not before the Commission and the Commission repeatedly has stated that it will not change the manner in which consumers obtain and pay for Internet access. Rumors to the contrary persist, however, and the FCC has received hundreds of thousands of e-mails on the subject over the last two years.

3. Are phone companies paying reciprocal compensation for Internet traffic now?

All 26 state regulatory commissions that have considered the issue have found that the phone company that originates a call to an ISP must pay reciprocal compensation to the competing phone company for delivering that traffic to an ISP, but many companies are withholding payment while pursuing appeals.

Many incumbent local telephone companies argue that Internet traffic is not local, because it often begins in one state and ends in another state, and therefore should not be subject to reciprocal compensation. These parties say that Internet traffic is more like long distance traffic, where the local phone company does not terminate the call locally, but rather hands the call off to a long distance company that carries the call over its interstate network to a distant location. Long distance companies pay access charges to the local phone company. If two local phone companies are involved in carrying the call to the long distance provider, the two local companies share the access charges paid by the long distance company and no reciprocal compensation is due. Unlike long distance carriers, ISPs do not pay access charges to local telephone companies.

4. What did the FCC conclude in its February 25, 1999 decision?

The Declaratory Ruling concludes that carriers are bound by their existing interconnection agreements, as interpreted by state commissions, and thus are subject to reciprocal compensation obligations to the extent provided by such agreements or as determined by state commissions. The Declaratory Ruling finds that Internet traffic is jurisdictionally mixed and appears to be largely interstate in nature. But, the Declaratory Ruling preserves the rule that exempts the Internet and other information services from interstate access charges. This means that those consumers may continue to access the Internet by dialing a seven-digit number and will not incur long distance charges when they do so. In a notice of proposed rulemaking, the Commission also asked for comment on proposals governing future carrier-to-carrier compensation for handling this traffic.

5. If reciprocal compensation does have to be paid in the case of Internet traffic (either through state or FCC decisions), won't the phone companies that have to pay that compensation be forced to impose a surcharge on their Internet customers or on ISPs (who will pass is through to consumers)?

No. While the rates consumers pay for local telephone service are regulated by the states, and not the FCC, most states require phone

companies to charge a flat rate for unlimited local usage. A local telephone company could not alter these local rates to include an internet surcharge without approval from the state commission. Moreover, local telephone companies are obtaining increased revenue from internet traffic, because many consumers are installing second lines dedicated to Internet traffic. Consumers pay for these lines just as they would pay for any second phone line.

Similarly, the local phone company cannot impose any charges on the ISP, even if it is forced to pay reciprocal compensation for traffic delivered by a CLEC to that ISP, because the ILEC has no direct billing relationship with the ISP.

6. Will the FCC's decision that calls bound for ISPs are interstate require ISPs have to pay access charges to local companies?

No. The FCC has a special exemption for ISPs, under which ISPs are treated as local phone customers and are exempt from interstate access charges paid by carriers. Thus, rather than paying higher access charges, ISPs simply purchase phone lines from the local phone company as any local business would do. Nothing in the FCC's February 25, 1999 decision affects this exemption.

7. Why is it necessary to consider this issue if 26 states have already decided it?

As discussed in the Declaratory Ruling, the FCC has jurisdiction over calls between states, while each state has jurisdiction for calls within its borders. Thus, the FCC has a statutory obligation regarding this traffic. In addition, a uniform national policy regarding inter-carrier compensation for the delivery of ISP traffic will aid the development of Internet, which is not confined by state, or even national, boundaries.

last reviewed/updated on 4/3/02

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NEWS

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This is an unofficial announcement of Commission action. Release of the full text of a Commission order constitutes official action. See *MCI v. FCC*, 515 F 2d 385 (D.C. Circ 1974).

FOR IMMEDIATE RELEASE
March 14, 2002

NEWS MEDIA CONTACT:
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FCC CLASSIFIES CABLE MODEM SERVICE AS "INFORMATION SERVICE"
Initiates Proceeding to Promote Broadband Deployment and Examine Regulatory Implications of Classification

Washington, D.C. - Today, the Federal Communications Commission (FCC) adopted another major rulemaking, part of a series of actions, designed to promote widespread deployment of broadband services. The FCC settled a debate over the regulatory classification of cable modem service and launched a proceeding to examine the proper regulatory treatment of this service.

In a *Declaratory Ruling* adopted today, the FCC concluded that cable modem service is properly classified as an interstate information service and is therefore subject to FCC jurisdiction. The FCC determined that cable modem service is not a "cable service" as defined by the Communications Act. The FCC also said that cable modem service does not contain a separate "telecommunications service" offering and therefore is not subject to common carrier regulation.

The FCC also adopted a *Notice of Proposed Rulemaking* to examine:

1. Certain issues in light of the FCC's recent initiation of the *Wireline Broadband NPRM*, including whether there are legal or policy reasons why it should reach different conclusions with respect to wireline broadband and cable modem service.
2. The scope of the FCC's jurisdiction to regulate cable modem service, including whether there are any constitutional limitations on the exercise of that jurisdiction.
3. Whether, in light of marketplace developments, it is necessary or appropriate at this time to require multiple ISP access.
4. The role of state and local franchising authorities in regulating cable modem service.

The FCC said that the ultimate resolution of this item will promote broadband deployment, which should result in better quality, lower prices and more choices for consumers. In considering the issues raised by the original *Cable Modem NOI* and today's *Notice*, the FCC

is guided by the following principles and policy goals:

- Encourage the ubiquitous availability of broadband access to the Internet to all Americans.
- Ensure that broadband services exist in a minimal regulatory environment that promotes investment and innovation.
- Develop an analytical framework that is consistent, to the extent possible, across multiple platforms.

With respect to state and local issues, the *Notice* makes three significant tentative conclusions:

- The statute does not provide a basis for a local franchising authority to impose an additional franchise for the provision of cable modem service.
- The provision of cable modem service should not affect the rights of cable operators to access the public rights-of-way.
- In the interest of national uniformity, the FCC should exercise its forbearance authority in light of the U.S. Court of Appeals for the Ninth Circuit's decision in the *Portland* case, which classified cable modem service as both an "information service" and "telecommunications service."

Regarding franchise fees, the FCC notes that the law limits franchise fees to 5 percent of the gross revenues the cable operator receives from cable service. The FCC said that revenues from cable modem service should not be used in computing this franchise fee ceiling.

Today's decision follows five other related proceedings - the *Cable Modem NOI*, the *National Performance Measures NPRM*, the *Incumbent LEC Broadband Notice*, the *Triennial UNE Review Notice* and, most recently, the *Wireline Broadband NPRM*. These proceedings, together with today's actions, are intended to build the foundation for a comprehensive and consistent national broadband policy.

-FCC-

CS Docket 00-185

CS Docket 02-52

Action by the Commission March 14, 2002, by Declaratory Ruling and Notice of Proposed Rulemaking (FCC 02-77). Chairman Powell, Commissioners Abernathy and Martin, with Commissioner Copps dissenting, and Chairman Powell, Commissioners Abernathy and Copps issuing separate statements.

Cable Service Bureau contacts: Sarah Whitesell, Royce Sherlock, Peggy Greene at 202-418-7200.

News about the Federal Communications Commission can also be found on the Commission's web site www.fcc.gov.

Halverson, Vicky

From: Frank P. Tower [frankt@northnet.net]
Sent: Friday, October 03, 2003 11:12 AM
To: rep.lehmanm@legis.state.wi.us
Subject: AB 234 Additional Information

Representative Lehman and members of the committee:

This email is being sent to provide additional information to add to my testimony on Assembly Bill 234.

The question arose as to what the FCC defined Internet access as -- my response in an earlier email showed that this is a definition of information service.

Recently the University of Wisconsin, working with Barry Orton, sponsored an Internet provider round-table on campus. In one of the sessions, two representatives from the Wisconsin Public Service Commission were present (specifically Jeff Richter and Chela O'Connor) and were asked as to their interpretation of Internet access. The response was that all Internet access, regardless of how its delivered (telephone line, DSL line, cable line, etc.) was an information service.

Thank you for your time and please feel free to contact me with any questions you may have.

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