CONGRESSIONAL BUDGET OFFICE
MANDATES STATEMENT

July 30, 1998

S. 442
Internet Tax Freedom Act

As ordered reported by the Senate Committee on Finance on July 28, 1998

SUMMARY

S.442 contains no private-sector mandates, but by imposing a moratorium on certain types of state and local taxes, the bill would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). For reasons described below, CBO cannot estimate whether the direct costs of this mandate would exceed the statutory threshold established in UMRA ($50 million in 1996, adjusted annually for inflation).

INTERGOVERNMENTAL MANDATES CONTAINED IN THE BILL

S. 442 would impose a two-year moratorium on certain state and local taxes, including taxes on Internet access and online services. This moratorium would constitute an intergovernmental mandate as defined in UMRA. The bill would not grandfather any states or localities that have already imposed such taxes.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE, LOCAL, AND TRIBAL GOVERNMENTS

Is the Statutory Threshold Exceeded?

Because it is unclear what should be counted as the direct costs of the moratorium, CBO cannot determine whether the threshold for intergovernmental mandates would be exceeded in either year of the moratorium.

Total Direct Costs of Mandates

UMRA defines the direct costs of an intergovernmental mandate as "the aggregate estimated amounts that all state, local, and tribal governments...would be prohibited from raising in revenues in order to comply with the federal intergovernmental mandate." Twelve states, including the District of Columbia, have sought to impose their sales and use taxes on Internet access and online services. (These twelve include Illinois, which taxes the services in only very limited circumstances.) Twelve home-rule cities in Colorado also impose such taxes.

Information from states and industry sources indicates that while total collections and unpaid assessments for all twelve states in 1997 were close to $50 million, actual collections alone were significantly lower than that amount. The difference occurs because, in some of the states, companies are challenging the applicability of the tax to the service they provide or the state's finding that they are obliged to collect the tax on the state's behalf. In those cases, the companies are not collecting or remitting the tax, but they are accruing a potential tax liability to the states. CBO is unsure whether a tax that is being assessed but is not being paid should be counted toward the direct costs of a mandate when the applicability or constitutionality of the tax is being litigated.

Whichever measure is used, the potential cost of the mandate would grow over the two years that the moratorium would be in effect, because of the projected growth of the market for Internet access and online services. Some industry analysts have predicted that the market will more than double in the next three years. Growth of this magnitude would push collections plus potential tax liability for the twelve states over $50 million, but whether actual collections would reach that threshold would depend on the outcome of litigation. If the states prevail in court, the total mandate cost for the twelve states would exceed the threshold.

It is possible that, in the absence of this legislation, some state and local governments would enact new taxes or decide to apply existing taxes to Internet access or online services during the next two years. It is also possible that some governments would repeal existing taxes or preclude their application to these services. Such changes would affect the ultimate cost of the mandate but are extremely difficult to predict. Therefore, for the purposes of estimating the direct costs of the mandate in this bill, CBO considered only the revenues from taxes that are currently in place.

The moratorium in S. 442 would also apply to "bit taxes," which are taxes based in some way on the volume of digital information being transmitted. According to both state officials and industry representatives, no state or locality has adopted this type of tax. In addition, the

moratorium would apply to "multiple or discriminatory taxes on electronic commerce." CBO could not identify any current state or local taxes that would clearly meet the definitions provided in the bill for these two types of taxes.

APPROPRIATION OR OTHER FEDERAL FINANCIAL ASSISTANCE PROVIDED IN BILL TO COVER MANDATE COSTS

None.

OTHER IMPACTS ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

S. 442 would establish an Advisory Commission on Electronic Commerce made up of federal officials and representatives of state and local governments, the electronic industry, and consumer groups. The commission would study and write a report on the tax treatment of Internet access and electronic commerce at the federal, state, local, and international levels. As part of its study, the commission could examine ways to simplify the administration of sales and use taxes on interstate commerce in general.

PREVIOUS CBO ESTIMATES

CBO has completed intergovernmental mandates statements for seven other versions of the Internet Tax Freedom Act. All but one of these versions would impose a moratorium on some categories of state and local taxes. In each case, we determined that the moratorium would constitute an intergovernmental mandate as defined in UMRA. The direct costs that we estimated for the mandate in each bill differed depending on the scope and duration of the moratorium. For two versions, we determined that the costs of complying with the mandate would exceed the threshold established in UMRA. For the remaining four versions, we could not determine whether the threshold was exceeded. H.R. 3849, as reported by the House Judiciary Committee on June 19, 1998, contained an intergovernmental mandate but did not include a moratorium on state and local taxes.

Date	Bill Number	Version	Threshold Determination
June 18, 1997	S. 442	As introduced	Threshold exceeded
January 21, 1998	S. 442	As ordered reported by Senate Commerce, Science and Transportation Committee	Cannot determine
March 25, 1998	H.R. 1054	As approved by a subcommittee of House Commerce Committee	Threshold exceeded
May 22, 1998	H.R. 3849	As ordered reported by House Commerce Committee	Cannot determine
June 19, 1998	H.R. 3849	As reported by House Judiciary Committee	Below threshold
June 23, 1998	H.R. 3529	As ordered reported by House Judiciary Committee	Cannot determine
July 20, 1998	H.R. 4105	As passed by the House of Representatives	Cannot determine

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