CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 12, 2007

H.R. 3678

Internet Tax Freedom Act Amendments Act of 2007

As ordered reported by the House Committee on the Judiciary on October 10, 2007

SUMMARY

H.R. 3678 would extend a moratorium on certain state and local taxation of online services and electronic commerce until November 1, 2011. The bill also would amend part of an exception to that prohibition for certain states. Under current law, the moratorium is set to expire on November 1, 2007. CBO estimates that enacting H.R. 3678 would have no impact on the federal budget, but it would impose significant annual costs on some state and local governments.

By extending and expanding the moratorium on certain types of state and local taxes, H.R. 3678 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the mandate would cause some state and local governments to lose revenue beginning in November 2007; those losses would exceed the threshold established in UMRA ($66 million in 2007, adjusted annually for inflation) beginning in fiscal year 2008. While there is some uncertainty about the number of states affected, CBO estimates that the direct costs to states and local governments would probably total more than $80 million annually. The bill contains no new private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO estimates that enacting H.R. 3678 would have no impact on the federal budget.

INTERGOVERNMENTAL MANDATES CONTAINED IN THE BILL

The Internet Tax Freedom Act (ITFA), as amended, currently prohibits state and local governments from imposing taxes on Internet access until November 1, 2007. The ITFA, enacted in 1998, also contains an exception to this moratorium, sometimes referred to as the grandfather clause, which allows certain state and local governments to continue taxing Internet access if such tax was generally imposed and enforced prior to October 1, 1998.

H.R. 3678 would extend the moratorium until November 1, 2011, and would amend part of an exception to that prohibition, effective on November 1, 2007. The effect of that amendment would be to prohibit state and local taxation of telecommunications services "purchased, used, or sold by a provider of Internet access" that the provider uses to connect its customers to the Internet. The new prohibition would ban taxes currently levied by some states on telecommunications services purchased by Internet service providers, also known as "backbone" services. These extensions and expansions of the moratorium constitute intergovernmental mandates as defined in UMRA because they would prohibit states from collecting taxes that they otherwise could collect, and in some cases, are currently collecting.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE AND LOCAL GOVERNMENTS

UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues to comply with the mandate. Amending the grandfather clause would result in direct costs (in the form of forgone tax revenues) to those state and local governments that are currently collecting such revenues but would be precluded from doing so after H.R. 3678 is enacted.

The primary budget impact of the bill would be the revenue losses—starting in November 2007—resulting from prohibiting state and local taxation of telecommunications services purchased by providers of Internet access. While there is some uncertainty about the number of jurisdictions currently collecting such taxes—and the precise amount of those collections—CBO believes that as many as eight states (Illinois, Pennsylvania, Alabama, Florida, New Hampshire, Missouri, Washington and Minnesota) and several local jurisdictions in those states are currently collecting such taxes. Those taxes total more than $80 million annually in just two states. This estimate is based on information from the states involved and from industry contacts.

It is possible that if the moratorium were allowed to expire as scheduled under current law, some state and local governments would enact new taxes or decide to apply existing taxes to Internet access during the next five years. It is also possible that some governments would repeal existing taxes or preclude their application to these services. Because such changes are difficult to predict, for the purposes of estimating the direct costs of the mandate, CBO considered only the revenues from taxes that are currently in place and being collected.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

This bill contains no new private-sector mandates as defined in UMRA.

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