

THE IMPACTS OF TAX POLICY ON BROADBAND CONNECTIVITY: THE GOOD, THE BAD & THE UGLY

1. Introduction

Tax policy plays an important role in enhancing broadband connectivity from both the supply side (*i.e.*, building and maintaining networks) and the demand side (*i.e.*, adoption and use by consumers).

On the supply side, for example, there are ongoing discussions at the federal and state levels about the extent to which taxes on infrastructure and service providers, as well as tax credits and other incentives, can facilitate investment in broadband deployment. These are critical points of discussion because broadband networks are very capital-intensive to construct, to maintain, to operate, and to upgrade. Indeed, each year service providers collectively invest \$70+ billion in their networks. (Ironically, there is growing evidence to suggest that recently enacted open Internet rules, which hinge on treating service providers as common carriers subject to extensive regulation, will dampen much-needed investment in broadband networks.)

On the adoption side, many agree that taxes on Internet access, online purchases, and wireless service are often regressive and, when overzealously imposed on a particular platform, can become barriers to use in certain communities. Even though significant

progress has been made in bringing more Americans online over the last decade, stubborn connectivity gaps remain in key demographics, including low-income households, seniors, and people with disabilities.

Given the high stakes surrounding broadband tax policy, the rhetoric of conversations about these taxes tends to be heated, generating impassioned debate by policymakers and subject-matter experts from across the political spectrum. Fortunately, there are many opportunities for policymakers to avoid a messy partisan quagmire and focus instead on implementing policies that can help to encourage further investment in and use of broadband services across the country. The following briefly discusses a range of tax policies that are ripe for reform at both the state and federal levels.

AT A GLANCE

- Federal, state, and local tax policies impact numerous aspects of broadband connectivity.
- Taxes levied on network inputs, service providers, customers, and digital services influence spending decisions on both the supply side and demand side.
- Policymakers have numerous opportunities to get tax policy right.

On the supply side:

- Reduce or remove state-level taxes on broadband equipment
- Make permanent bonus depreciation

On the demand side:

- Make permanent the federal moratorium on Internet access taxes
- Rationalize state and local taxes on digital and wireless services to protect against unintended regressive outcomes

2. Tax Policy & Broadband Supply

Equipment Taxes. One area ripe for reform is the imposition of taxes on the purchase of wholesale broadband equipment. Such input taxes have been largely eliminated in other contexts (e.g., taxing of farming implements). Taxing broadband equipment in this manner diverts money from more critical and impactful uses of funds, like bolstering network speeds and coverage. Indeed, according to [one estimate](#) from 2012, *reducing or eliminating these kinds of taxes would result in significant increases in investment by service providers. A nationwide exemption could yield more than \$7 billion in additional economic activity in the first year alone.*

About half the states still have these kinds of taxes on the books – and this creates an opportunity for reform. Governors of all political persuasions, and state legislators, should revisit their respective equipment tax policies to free up potential additional funding for broadband deployment.

Bonus Depreciation. Another tax policy that has been closely linked with increased investment in broadband networks, as well as job creation and other important economic activity, is “bonus depreciation.” This [refers](#) to a federal policy that allows broadband firms to “deduct 50 percent of their capital expenditure costs upfront instead of over time.” The availability of this incentive has been cited by [service providers](#) and the [President](#) as key drivers of additional investment in broadband infrastructure across the U.S.

Bonus depreciation policy, though, is in a constant state of flux since it must be renewed on an annual basis, a fate that has befallen many other worthwhile – and traditionally bipartisan – programs and incentives because of increased partisanship and Congressional inaction. Last year, after much lobbying and discussion over the course of many months, it [took until late December](#) for Congress to renew bonus depreciation. While it was greeted enthusiastically by service providers, as well as a broad range of small and mid-sized manufacturers, suppliers, and other job creators, *this year-to-year dynamic of*

approval and near-expiration is not sustainable over the long-term because it creates unnecessary uncertainty for those looking to make new investments throughout the year. If the ultimate goal is to promote additional capital investment in broadband networks – decisions that take time to plan and that often play out over an extended period of time – then Congress should act to extend bonus depreciation and related incentives indefinitely, or at least for longer than one year at a time. Doing so will provide much-needed certainty to those looking to invest in broadband.

3. Tax Policy & Broadband Demand

Access Taxes. Ever since the Internet became commercially available in the U.S. in the mid-1990s, the federal government has – on a bipartisan basis – prohibited states from levying taxes on Internet access. The rationale was that every effort should be made to avoid inflating the price of accessing what many foresaw as a critical space for e-commerce and other economic activity. For some two decades, Congress has kept this moratorium on state-level Internet access services in place, and access to and use of the Internet has flourished.

Unfortunately, as with bonus depreciation, *the long-term prospects of maintaining this essential tax prohibition is in danger of lapsing thanks to Congressional gridlock.* More specifically, the Internet Tax Freedom Act, which has been continuously extended for the last 15 years, is set to expire on October 1 of this year. The House adopted a [permanent version](#) of this bill in early 2015, but it remains to be seen whether the issue, long one that has garnered bipartisan support, will be taken up in the Senate and enacted. While the moratorium may be extended again, which would be a win for consumers, a permanent enactment of the moratorium would avoid the recurring and unnecessary uncertainty that annual political brinksmanship engenders.

Digital Service Taxation. With the proliferation of, and shift to, digital-only commerce, states are exploring an array of new tax policies in an effort to offset declining tax revenues from traditional bases. A major target

has been digital media services like cloud-based applications and streaming video. States such as Idaho and Tennessee have already implemented taxes on these kinds of services; Chicago recently levied a “cloud tax” “[targeting online databases and streaming entertainment services](#).” The legality and efficacy of these new taxes, however, remains in question. As the Wall Street Journal [recently reported](#), “The result is a patchwork of tax policies – and some new laws – for fast-growing slices of consumer and business sales. While taxes on digital entertainment and software represent only a sliver of the \$271 billion that states collected in sales taxes last year, the issue highlights the challenge states and localities face as technologies rapidly shift.” This discussion comes several years after a number of states began requiring “[sales tax collection on online purchases when an affiliate is used to sell goods](#).”

The array of new taxes being proposed for and levied on digital services could have a number of unintended consequences on consumers and on firms looking to do business in a city or state. As such, policymakers at every level of government would be wise to evaluate and make clear to the public whether the perceived benefits of these policies outweigh the very real costs they impose on consumers and commerce generally.

Wireless Taxation. The many state and local taxes that are heaped on wireless service are regressive – in a nutshell, such taxes drive up prices for consumers.

According to [MyWireless.org](#), “The average wireless consumer now pays more than 17% in combined state, local and federal wireless taxes and fees. That’s more than double the average sales tax rate of about 7% paid on other goods or services.” State and local governments have zeroed in on wireless service as a prime target for incremental tax increases, viewing this exceedingly popular and increasingly essential service as vehicle for delivering ever more tax revenues. In [some parts of the country](#), like Washington, Nebraska, and New York, consumers pay nearly 20% in state and local taxes on wireless service. When combined with federal taxes

that support universal service, these rates can climb to almost 25%. While these extra fees might seem like an annoyance that is easily (albeit begrudgingly) accommodated by some higher-income wireless users, *such high tax rates are ultimately [regressive](#) because they impose disproportionately heavy burdens on low-income and working class customers, many of whom can ill-afford to pay more for wireless service.*

There have been numerous attempts in recent years to rationalize how wireless services are taxed. One major push has come at the federal level, where there appears to be [broad bipartisan support](#) in Congress for legislation that would prevent state and local governments from taxing wireless in this manner. Unfortunately, efforts to advance legislation have stalled in recent years. Similarly, state and local efforts to rein in wireless taxes have also failed to gain momentum as policymakers are loathe to cannibalize what they consider to be a reliable revenue stream. In the meantime, regressive wireless taxes are still being paid by those who can least afford it, creating an unfortunate dynamic that shows little sign of abating. Ultimately, failure to reform these taxes hinder the more robust growth of a technology that is vital to everyday life and [essential to American economic activity](#).