

# HOUSE BILL REPORT

## SSB 5763

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### As Reported By House Committee On:

Energy & Utilities  
Finance

**Title:** An act relating to prohibiting the taxation of Internet service providers as network telephone services providers.

**Brief Description:** Prohibiting the taxation of Internet service providers as network telephone service providers.

**Sponsors:** Senate Committee on Energy & Utilities (originally sponsored by Senators Finkbeiner, Brown, Rossi, McAuliffe, Roach, Kohl, Jacobsen, Hochstatter, Haugen, Goings and West).

### Brief History:

#### Committee Activity:

Energy & Utilities: 3/26/97 [DPA];

Finance: 4/3/97 [DPA(EN)].

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## HOUSE COMMITTEE ON ENERGY & UTILITIES

**Majority Report:** Do pass as amended. Signed by 13 members: Representatives Crouse, Chairman; DeBolt, Vice Chairman; Mastin, Vice Chairman; Poulsen, Ranking Minority Member; Morris, Assistant Ranking Minority Member; Bush; Cooper; Honeyford; Kastama; Kessler; Mielke; Mulliken and B. Thomas.

**Staff:** Margaret Allen (786-7110).

**Background:** The Internet is an international network of computer networks, that interconnect computers which range from simple personal computers to sophisticated mainframes. It is a dynamic, open-ended aggregation of computer networks, rather than a physical entity. Internet users can access or provide a wide variety of information, purchase goods and services, and communicate with other users electronically. Some information on the Internet is available at no charge, while other information is available only if the user pays a subscription or use fee.

Definitions. The Telecommunications Act of 1996 defined the Internet as the international computer network of both federal and nonfederal interoperable packet switched data networks.— Interoperable— means the computers and systems can

communicate with each other. The phrase packet switched data networks— means unstructured data signals are electronically wrapped and addressed in packets— for efficient transmission through the network.

The world wide web— (web), a widely used subnetwork of the Internet, is a network of computers using web application software. Before the web was developed, only text was available over the Internet. Web browsing software has made it possible to transfer sound, video and colors, as well as text, over the Internet. Consequently, the web is described as being graphical.—

Access to the Internet and Proprietary Networks. Some companies are in the business of providing access to the Internet via computers that are directly linked to the Internet by telecommunications facilities. Using a computer, a modem, and software that allows access to the Internet, a customer dials a local or 800 telephone number to reach the access provider's computer, which then connects the user's computer to the Internet.

Other companies, often referred to as on-line service providers,— provide access to a proprietary subscriber network, and may also provide access to the Internet.

Internet access and on-line service providers (collectively referred to as access providers—) generally charge their customers subscription or usage fees.

Taxation. Since Internet access requires the use of telecommunications facilities, largely the telephone network, the issue has been raised of whether Internet access should be taxed as a network telephone service— or as a business service.—

Local Taxes. Unless the voters approve a higher rate of taxation, cities may impose a 6 percent tax on the gross receipts of a telephone service, and a 0.2 percent tax on the gross receipts of a business service.

State Taxes. The state's primary tax on business is the business and occupation (B&O) tax. The tax is imposed on the gross income of a business from activities conducted within the state. The tax rate varies for different kinds of businesses.

The B&O tax rate for selected business services— is 2.0 percent. Examples of selected business services include computer services, data processing services, information services (such as electronic data retrieval), legal services, and engineering services. According to the Department of Revenue, Internet access is currently taxed at the selected business services— rate. The current B&O tax rate for other services is 1.83 percent. When a temporary surcharge expires June 30, 1997, the tax rate on other services will be 1.75 percent.

**Summary of Amended Bill:** The Legislature finds that the newly emerging business of providing Internet service is beneficial to all levels of society. The Legislature further finds that the business is important to the continued growth of the high-technology sector of the state's economy, and should not be burdened by new taxes that might be inappropriate for the kind of service being provided.

Definitions. Internet— is defined as the international computer network of both federal and non-federal interoperable packet switched data networks, including the graphical subnetwork called the World Wide Web.

Internet service— is defined as a service that includes computer processing applications, provides the user with additional or restructured information, or permits the user to interact with stored information through the Internet or a proprietary subscriber network. Internet service includes provision of Internet electronic mail, access to the Internet for information retrieval, and hosting of information for retrieval over the Internet or the graphical subnetwork called the World Wide Web.

Local Taxes. Until July 1, 1999, a city or town may not impose any new taxes or fees specific to Internet service providers. A city or town may impose general business taxes on Internet service providers, at a rate not to exceed 0.2 percent unless a higher rate is approved by the voters.

State Taxes. An existing statute is amended to clarify that Internet service is to be taxed at the selected business services— tax rate. If the selected business service— tax classification is repealed, the provision of Internet service will be taxed as a general service.

An additional statute is amended to clarify that the provision of Internet service is not network telephone service, although the provision of transmission to and from the site of an Internet provider via a local telephone network, toll line or channel, cable, microwave, or similar communication transmission system, is network telephone service.

If any provision of the act is found to be invalid, the finding of invalidity does not affect the other provisions.

**Amended Bill Compared to Substitute Bill:** The amended bill modifies the local tax provisions. The amended bill prohibits cities from imposing any new taxes or fees specific to Internet service providers, but allows cities to impose general business taxes. The substitute bill allowed cities to tax Internet service providers under the B&O service classification only.

The amended bill explains how the state is to tax Internet services if the selected business services— classification is repealed.

The amended bill adds a statement that the Legislature finds there is no clear statutory guidance as to how Internet services should be classified for tax purposes and intends to ratify the state's current treatment of such services.

Finally, the amended bill makes technical changes to the substitute bill.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** The bill contains an emergency clause and takes effect immediately.

**Testimony For:** Some cities are looking at taxing the provision of Internet access. The underlying transmission services provided by telecommunications companies are already taxed at the state and local levels. Although telecommunications-like services may be a very small component of Internet and online services, Internet and online services are not themselves telecommunications services. Tax policy should not be developed in a vacuum, as often happens with new businesses. This bill is an attempt to let the industry grow and to encourage people to use the Internet while a comprehensive tax policy is developed. Current telecommunications tax laws are inconsistent; a temporary moratorium so there is time to study the issues is appropriate. A moratorium means software companies already in the state will be more likely to remain in this state.

**Testimony Against:** None.

**Testified:** (Pro) Gary Gardner, Washington Association of Internet Service Providers; Steve Duncan and Kathy Wilcox, Washington Software Association; and Matt Lampe, city of Seattle.

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## HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass as amended by Committee on Energy & Utilities. Signed by 13 members: Representatives B. Thomas, Chairman; Carrell, Vice Chairman; Mulliken, Vice Chairman; Dunshee, Ranking Minority Member; Dickerson, Assistant Ranking Minority Member; Boldt; Butler; Conway; Kastama; Morris; Pennington; Thompson and Van Luven.

**Staff:** Bob Longman (786-7139).

**Summary of Recommendation of Committee on Finance Compared to Recommendation of Committee on Energy & Utilities:** No new changes were recommended.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** The bill contains an emergency clause and takes effect immediately.

**Testimony For:** The city of Tacoma considered taxing Internet access providers as utilities last fall. This would be inappropriate because these providers are not telecommunications companies. This industry did not exist a few years ago. The whole area of telecommunication taxation will be reviewed in the near future. The cities are not opposed to this bill in principle, but the changes to the definition of network telephone service should be sunsetted as well.

**Testimony Against:** None.

**Testified:** Gary Gardner, Washington Association of Internet Service Providers; Steve Duncan, Washington Software Association; Barry Murphy, Microsoft Corporation; and Victoria Lincoln, Association of Washington Cities (all pro).