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Municipalities Can't Tax Internet Providers, Except When They Can.

Local governments are hurting from lost telecom franchise fees as the industry relies more and more on broadband, but cities can tax Internet providers and restore lost funds.

Mention the word "landline" to modern consumers, and you'll likely get the same quizzical look as if you'd said "rotary phone." As consumers shift almost uniformly to mobile phones and larger organizations rely on cable connections instead of DSL for their office "landlines," the local income associated with telecom franchise fees has nosedived.

Adding to the complexity of the revenue issue is the Internet Tax Freedom Act (ITFA) of 1998, which prohibits taxing Internet usage – so, even though telecommunications companies are utilizing locally-owned phone lines to provide broadband Internet access to residents, localities can no longer tax the services being provided like they used to. However, creative minds have been working to find ways that accommodate the various federal statutes while still increasing revenue for local governments.

In recent months, cities have started to pass legislation allowing localities to tax Internet providers directly for using city right–of-ways (ROWs). It's a highly technical loophole, but with broadband being at the forefront of the next major tax revolution, its one that your municipality may want to consider – and soon.

Cities That Tax Internet Providers

In 2016, for example, the Supreme Court of Oregon recently upheld the city of Eugene's seven percent tax on Internet providers for utilizing city ROWs to deliver its broadband services. Its decision was based on the ambiguous language used by the Federal Communications Commission (FCC) – they determined that the provisions of the Cable Act can more precisely be read as limitations only on the cable franchising process and the terms that may be included in a cable franchise agreement.

In other words, local governments have every right to regulate the business activities that are being conducted within their territory, especially when the city's ROWs are being used for those activities.

Oregon isn't the only state to subject telecoms companies to such regulations. Even a decade ago in 2008, the U.S. Court of Appeals ruled in favor of Jefferson City, Missouri, that that cellular services provided through public ROWs, including those that are bundled with Internet data access charges, are subjected to a tax on telecommunications providers.

State Legislative Restrictions

Telecom companies are predictably against this type of emerging legislation. With more than 80 percent of their revenue being derived from broadband now, they do not want states or cities to be able to levy taxes on these services and are taking action to prevent such legislation.

Just this year, two legislatures in Texas passed bills that would prohibit local governments from enforcing telecom license fees, and more are surely in the works. The telecommunications industry has deep pockets and a vested interest in this issue – so time is of the essence for municipalities that want to take action.

These ongoing legal battles point toward a future in which telecoms companies are once again contributing more significantly to local government revenue. And the solutions to the issue of lost telecom revenue are realistic, viable and capable of being implemented; provided they are done correctly.

Cities wishing to enforce their own regulations for use of city ROWs should know that their efforts to do so must be artfully crafted and specifically tailored to withstand scrutiny under federal regulations and provisions under the Cable Act and the ITFA. While cable and telecommunications conglomerates are notorious and financially capable of mounting strong defenses of any efforts to enforce or expand the taxes levied upon them, they are not able to counter local governments' lawful efforts to implement such measures.

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October 26, 2018

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