

The Excessive State and Local Tax Burden on Wireless Telecommunications Service

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Introduction

Nearly four years after the National Governors' Association¹ and the National Conference of State Legislatures² urged states to reform and modernize their telecommunications taxes, most states have failed to enact meaningful reforms of the excessive taxes on telecommunications customers. In fact, several states have expanded the use of telecommunications-specific taxes on wireless and other telecommunications services. While a few states have passed reforms to centralize collection of local telecommunications taxes and reduce administrative burdens on providers, they have done so while preserving excessively high transaction taxes on telecommunications service.

Many of the taxes imposed by state and local governments are throwbacks to the monopoly telecommunications era. These taxes are levied at rates significantly above those of consumption taxes (typically sales and use taxes) on other goods and taxable services. Despite the fact that Congressional policy enabled the U.S. wireless industry to develop as a competitive industry, state and local policymakers continue to impose monopoly-era telecommunications taxes on wireless service in the interest of "competitive neutrality" with other types of telecommunications service. A more appropriate policy would be the elimination of excessive taxes on all telecommunications service, not the expansion of excessive taxes to wireless service.

The imposition of double digit state-local transaction taxes on the wireless industry – the current practice in 19 states – raises important equity questions. Beyond equity issues, however, there are critical economic issues raised by excessive state and local tax burdens on the competitive wireless industry. Excessive telecommunications taxes were first levied in an era of

monopoly service when customer demand was price inelastic, meaning that customer demand was not at all responsive to price. Under these market conditions, an additional tax could be imposed on the company and passed on to consumers as higher prices without significantly reducing demand for the service.

The wireless industry, like any other competitive, technology-based industry, is ill suited to this type of taxation because consumer demand is price sensitive (price elastic in the language of economists). Recent studies have estimated that the price elasticity of demand for wireless service is between -1.12 and -1.29³, meaning that every 1 percent increase in price reduces demand for the service by between 1.12 and 1.29 percent. When a state like Florida or New York imposes a 16 percent tax on wireless service, demand for wireless service is reduced by between 17.9 and 20.7 percent.

Some state policymakers have questioned whether excessive taxes have hurt the wireless industry given the rapid subscriber growth of the industry between the mid-1990s and today. Some have even gone so far as to suggest new wireless taxes do not hurt the industry because, after all, companies are giving away free phones. Statements such as these reflect a poor understanding of how the wireless industry has evolved.

The wireless industry invested billions of dollars “up front” to purchase spectrum licenses and spent billions more to build wireless networks from scratch. Conversely, the wire line telecommunications network was built under a regulatory structure where infrastructure investments were approved by regulators and returns on those investments were guaranteed under “rate of return” regulation of prices. Wireless providers had no such guarantees, and some wireless companies are just now starting to turn profitable after years of losses, while others have yet to break even.

It is true that the number of wireless subscribers have grown from 16 million to 163 million over the last decade.⁴ During this same period, the average cost of wireless service has dropped from over \$.47 per minute to about \$.10 per minute.⁵ Wireless subscriber growth has been driven by major reductions in the price of wireless service, the rollout of national pricing plans, the expansion of coverage in unserved and underserved areas, and consumer preferences. Much of the expansion in the number of wireless subscribers is attributable to rapid reductions in the average cost per minute of service. Competition and the development of nationwide calling networks have been key factors in lowering consumer prices.

The question for policymakers and the industry is this, “How much have excessive taxes on wireless customers slowed industry growth below what it would have been if wireless service had been subject only to sales and use taxes, and what impact have excessive taxes had on wireless infrastructure investments?”

State policymakers frequently use tax policy to discourage demand for a product, such as levying excise taxes on cigarettes or alcoholic beverages. Ironically, in the case of wireless and other telecommunications services, state elected officials and economic development specialists are intent on expanding investment in telecommunications infrastructure to expand the availability of “broadband” service to more households and businesses. At the same time, many

states and localities impose excessive taxes that actually discourage the investment that economic development experts are trying to attract.⁶ State tax policies that impose high state and local taxes on wireless service work against states' economic development interests by slowing investment in wireless networks, since tax-induced reductions in demand reduce cash flow available for capital investment.

This paper examines recent trends in state and local taxation of wireless telecommunications service and the detrimental impact of such taxes on demand for wireless service and investment in the wireless infrastructure. It discusses recent state telecommunications tax reforms in the states and why most reform efforts have ignored high tax rates on telecommunications services. Finally, it suggests ways that states and local governments can be weaned from their reliance on excessive telecommunications taxes.

The Wireless Tax Burden in Detail

For this report, the author calculated the tax burden on wireless customers using the methodology from the 1999 Committee on State Taxation study, "50-State Study and Report on Telecommunications Taxation."⁷ It includes transaction taxes such as sales and use taxes, telecommunications excise taxes, 911 fees, universal service fees and other regulatory fees. It also includes gross receipts taxes that are passed on to customers. In order to facilitate comparisons between states, the study uses the COST report's methodology and averages local tax rates from the state's largest city and the state's capitol city to approximate a state's local taxes. In the case of flat rate impositions, such as a \$0.50 cent per month tax, the report uses the Cellular Telecommunications and Internet Association's estimate of the average monthly revenue per customer (in this case, \$48.40 per month) to convert the flat rate to a percentage calculation.

Table 1 on the next page shows the effective tax rate on wireless customers in the 50-states and the District of Columbia, ranked from highest to lowest. Detail on the specific type of tax and the rate in each state is provided in Appendix A.

The average state-local transaction tax burden on wireless service stands at 8.84 percent, up nearly ½ percentage point from the average rate of 8.38 percent at the end of 2002. In contrast, the average state-local sales and use tax rate imposed on taxable goods and services increased from 5.99 percent to 6.04 percent during the same period. The effective rate of taxation of wireless service, already significantly above the rate imposed on other goods and services taxable under sales and use taxes, increased seven times faster than the rate on other taxable goods and services between January 2003 and April 2004.

The effective rate on wireless is even higher when the rates are weighted by state population, with an effective tax rate of 10.74 percent compared to 6.93 percent for other taxable goods and services. The weighted average rate provides a more accurate indicator of what the "typical" wireless customer pays in taxes. Table 2 shows the different average effective rates for wireless service as compared to the general sales tax, and how those rates have changed between 2003 and 2004.

Table 1 – Federal/State/Local Taxes on Wireless Service – April 1, 2004

	State-Local	Federal Excise Tax	Federal USF*	TOTAL
New York	16.23%	3.0%	2.48%	21.71%
Florida	16.12%	3.0%	2.48%	21.60%
Washington	16.04%	3.0%	2.48%	21.52%
Illinois	15.57%	3.0%	2.48%	21.05%
Nebraska	15.13%	3.0%	2.48%	20.61%
Texas	14.19%	3.0%	2.48%	19.67%
Rhode Island	14.07%	3.0%	2.48%	19.55%
Pennsylvania	13.57%	3.0%	2.48%	19.05%
California	13.18%	3.0%	2.48%	18.66%
District of Columbia	12.57%	3.0%	2.48%	18.05%
South Dakota	12.01%	3.0%	2.48%	17.49%
Tennessee	11.57%	3.0%	2.48%	17.05%
Missouri	11.12%	3.0%	2.48%	16.60%
Arizona	11.06%	3.0%	2.48%	16.54%
North Dakota	10.94%	3.0%	2.48%	16.42%
Wyoming	10.67%	3.0%	2.48%	16.15%
Kansas	10.32%	3.0%	2.48%	15.80%
Utah	10.25%	3.0%	2.48%	15.73%
Arkansas	10.21%	3.0%	2.48%	15.69%
Kentucky	9.98%	3.0%	2.48%	15.46%
Indiana	9.62%	3.0%	2.48%	15.10%
Oklahoma	9.58%	3.0%	2.48%	15.06%
Colorado	9.37%	3.0%	2.48%	14.85%
Mississippi	9.07%	3.0%	2.48%	14.55%
Minnesota	8.10%	3.0%	2.48%	13.58%
New Hampshire	7.87%	3.0%	2.48%	13.35%
Virginia	7.75%	3.0%	2.48%	13.23%
North Carolina	7.65%	3.0%	2.48%	13.13%
Georgia	7.64%	3.0%	2.48%	13.12%
New Mexico	7.63%	3.0%	2.48%	13.11%
Ohio	7.63%	3.0%	2.48%	13.11%
Alabama	7.45%	3.0%	2.48%	12.93%
Vermont	7.27%	3.0%	2.48%	12.75%
Maryland	7.07%	3.0%	2.48%	12.55%
Michigan	7.07%	3.0%	2.48%	12.55%
Iowa	6.53%	3.0%	2.48%	12.01%
Maine	6.53%	3.0%	2.48%	12.01%
South Carolina	6.50%	3.0%	2.48%	11.98%
Connecticut	6.41%	3.0%	2.48%	11.89%
Hawaii	6.14%	3.0%	2.48%	11.62%
New Jersey	6.00%	3.0%	2.48%	11.48%
Massachusetts	5.63%	3.0%	2.48%	11.11%
Wisconsin	5.55%	3.0%	2.48%	11.03%
Delaware	5.49%	3.0%	2.48%	10.97%
Montana	4.99%	3.0%	2.48%	10.47%
Louisiana	4.39%	3.0%	2.48%	9.87%
Alaska	4.05%	3.0%	2.48%	9.53%
Oregon	2.27%	3.0%	2.48%	7.75%
Idaho	2.23%	3.0%	2.48%	7.71%
West Virginia	1.94%	3.0%	2.48%	7.42%
Nevada	1.14%	3.0%	2.48%	6.62%
US Average (Simple Avg.)	8.84%	3.0%	2.48%	14.32%

* USF Percentage -- 28.5% FCC "Hold Harmless" times FCC "contribution factor" of 8.7%

Table 2. Average State-Local Tax Rates: Wireless vs. Sales and Use Tax

Type of Tax	Simple Avg. 1/1/2003	Simple Avg. 4/1/2004	Weighted Avg. 1/1/2003	Weighted Avg. 4/1/2004
Tax Rates – Wireless Service	8.38%	8.84%	10.20%	10.74%
Tax Rates – General Sales and Use	5.99%	6.04%	6.87%	6.93%

Table 3 shows why the effective tax rate is higher when weighted for state population. Customers in the states with the largest populations tend to be those facing the highest effective tax rates. All five of the most populous states have rates significantly about the national average. Six of the ten most populated states – California, New York, Texas, Florida, Illinois, and Pennsylvania – are also on the list of the ten highest tax rates on wireless customers.

Table 3. State-Local Effective Tax Rates on Wireless Customers in the Top Five Population States

	State-Local Tax Rate
California	13.36%
Texas	14.19%
New York	16.23%
Florida	16.12%
Illinois	15.57%
US Weighted Avg.	10.72%

State and local tax rates only tell part of the story of the tax burden on wireless service. Wireless carriers are also subject to the 3 percent federal excise tax on telecommunications and must also contribute to the federal universal service fund (USF). The weighted average of all taxes on wireless customers 16.2 percent as compared to 6.93 percent for other goods and services. Other than telecommunications, only tires, cigarettes, gasoline, guns and ammunition, and some other hunting and fishing equipment are subject to federal consumption taxes.

Why are Wireless Tax Burdens So High?

There are four primary reasons why wireless and other telecommunications customers face excessive state and local taxes as compared to goods and services subject to the sales and use tax: 1) the federal excise tax and the federal USF; 2) state and local industry-specific taxes on telecommunications for general revenue purposes; 3) 911 taxes and fees to support development and operation of the 911 system (in some states, funds are routinely diverted to non-911 uses); and 4) other special purpose charges such as regulatory fees, universal service fees, and deaf relay service fees.

The largest state and local impositions on wireless service are industry-specific telecommunications taxes for general fund purposes. Many of these taxes have been imposed for decades.⁸ Some were originally imposed in exchange for monopoly franchise agreements for exclusive rights to provide telecommunications service in a specified state or locality. Since telephone rates were regulated at the time these taxes were first imposed, state public utility

commissions typically permitted the companies to recover the taxes through the rate base without any impact on the company bottom line.

The breakup of the telephone monopoly and the subsequent federal deregulation of the telecommunications industry undermined the rationale for this system of taxation. Congress and the FCC permit companies selling interstate telecommunications service to include previously “hidden” taxes on customer bills. As telecommunications companies began to compete to sell more and more services, it became increasingly difficult for states to impose such taxes without customers being aware of them.

Today, in the majority of states, telecommunications customers face some type of state and local “industry-specific” tax on wireless and other telecommunications services. Examples at the state level include Florida, Illinois, and the District of Columbia. These states exempt telecommunications from the sales and use tax and impose a special excise tax on telecommunications. In the 2004 session, Maine exempted telecommunications service from the sales and use tax and included it in a new “services” tax.⁹

Other states impose the sales and use tax on telecommunications service, but also impose an additional gross receipts or excise tax on telecommunications. Examples include Indiana, New York, North Dakota, Pennsylvania, Rhode Island, South Dakota (wireless only), and Texas.

In addition, three of the four states that do not have a general sales tax at the state or local level impose a special tax on telecommunications. New Hampshire’s 7 percent communications services tax is the highest, followed by Delaware’s 4.25 percent gross receipts tax and Montana’s 3.75 percent telecommunications excise tax. Oregon does not impose a general purpose tax on wireless service.

Local governments rely very heavily on taxes on telecommunications services because, historically, monopoly franchises were granted at the local level in many states. For this reason, some of the most onerous telecommunications taxes are local taxes authorized by state statute or imposed through local home rule authority. Examples of states with widespread local taxes on wireless service include California, Florida, Illinois, Kentucky, Maryland, Missouri, New York, Utah, Virginia, and Washington. In California, for example, the city of Los Angeles imposes an 10 percent general purpose tax on telecommunications service. The City of Clayton, Missouri imposes an 8 percent business license tax for the “privilege” of providing wireless service to a customer located the city – a tax imposed in addition to state and local sales taxes on wireless service.

Recent State and Local Tax Increases

As shown previously in Table 2, taxes on wireless services increased nine times faster than taxes on goods and services taxable under the sales and use tax. Between January 2003 and April 2004, the weighted average effective tax rate imposed on wireless customers increased from 10.2 percent to 10.74 percent. During that same time period, the average effective general sales and use tax rate increase from 6.87 percent to 6.93 percent.

Instead of addressing the excessive tax burden on wireless service, states and localities have increased the level of taxes on wireless service. The increase in the average state-local tax on wireless service was due primarily to new taxes on wireless service imposed in Pennsylvania and South Dakota. Also contributing to the increase in the wireless customer tax burden were general sales and use tax rate increases in Arkansas, New York, Ohio and an increase in the sales tax rate on telecommunications service in Vermont. Additionally, a handful of states either increased the 911 fees or began imposing 911 fees on wireless service.

The largest new tax imposition on wireless customers was in Pennsylvania, which imposed a new 5 percent gross receipts tax on wireless and interstate long distance services. The Pennsylvania Legislature and Governor did exactly the opposite of what the NCSL and NGA reports recommended. Instead of eliminating the monopoly-era gross receipts tax on intrastate service, it expanded that tax to wireless and interstate long distance in order to “level the playing field.” As a result of this action, plus the imposition of a new statewide \$1.00 per month 911 tax on wireless service, Pennsylvania wireless customers have seen their taxes more than double from 6.5 percent to almost 14 percent between December 31, 2003 and April 1, 2004.

South Dakota imposed a 4 percent gross receipts tax on the wireless industry in 2003. Proceeds from the tax were used to, in part, provide aid to county governments. Wireless customers in South Dakota now pay about 12 percent in state and local transaction taxes.

An emerging issue for wireless customers is the threat of proliferation of local taxes in several states. In 2003, the Maryland legislature granted Prince Georges County the authority to impose a new 8 percent local tax on wireless service to fund schools. Also in 2003, Montgomery County imposed a new \$2.00 monthly tax on wireless service. This year, Anne Arundel County and Baltimore City have attempted to impose taxes on wireless service without legislative approval. Cities in California and Missouri are also attempting to impose taxes and fees on wireless service.

The city of Springfield, Oregon announced in April 2004 that it will try to impose a 5 percent tax on wireless and interstate telecommunications service by local ordinance, even though state statutes specifically authorize taxes only on “utilities” actually using the public right-of-way. If successful in this effort, this could open the floodgates for new local tax impositions on wireless and other telecommunications service.¹⁰

The potential proliferation of new local taxes on wireless service in several states raises the dual specter of massive new administrative and compliance burdens being imposed on the wireless industry, as well as significant new taxes on customers that add to the cost of their wireless service. Once again, the wireless industry is confronted with the potentially damaging impact of excessive taxes. These taxes reduce demand for wireless service and hamper industry’s ability to generate revenue necessary to invest in the improving wireless networks. The economic development impacts of this potential proliferation of punitive local taxes on wireless customers needs to be examined by state legislatures in those states where local governments are aggressively seeking to impose new tax burdens on wireless customers.

Recent State “Reforms”

Since 1999, to the extent that states have reformed their telecommunications taxes at all, they have focused on reducing the administrative burden of compliance. Florida reformed its tax system in the 2000 and 2001 legislative sessions by centralizing collection of all state and local taxes with the Department of Revenue, and by replacing a handful of local taxes with a single local tax.¹¹ The price of this reform, however, was “revenue neutrality” that set rates at very high levels. Wireless customers in Florida face the second highest state-local tax burden in the country, just over 16 percent of their bills. Examples include Tallahassee, which levies a 6.02 percent tax on top of the state’s 9.17 percent tax and a \$.50 monthly 911 fee – a total effective tax rate of 16.2 percent.¹² By contrast, the combined state-local sales tax rate is 7 percent in Tallahassee.

Illinois enacted a similar reform in 2002, reducing administrative burdens on companies by centralizing the filing of returns with the state but locking in very high rates of taxation.¹³ While the reforms significantly reduced the cost of complying with local taxes, Illinois currently has the fourth highest wireless tax burden on customers, averaging just over 15.5 percent.

One state that adopted a reform that could serve as a national model is Ohio. In 2003, the legislature approved legislation that brought taxation of all telecommunications services under the state sales and use tax and repealed sales and use tax exemptions for certain types of telecommunications services.¹⁴ Prior to the reform, providers of local telephone service were subject to a gross receipts tax while wireless and other services were subject to the sales and use tax. The reform brought all services under the sales tax and taxed all telecommunications providers under the corporation income tax on income earned in Ohio. As a result, telecommunications services are taxed at the same rate and in the same manner as other taxable services.

Industry Responses to Excessive Taxation

The telecommunications industry began to focus in earnest on the impact of excessive taxation on the industry and its customers in the late 1990s. In 1999, representatives of the telecommunications industry testified before the federal Advisory Commission on Electronic Commerce (ACEC) about the burden of telecommunications taxes on the industry and its customers.¹⁵ The ACEC was tasked with recommending what actions, if any, that the Congress should take to promote the development of the electronic commerce marketplace in the US. Since the telecommunications backbone is a vital component of the Internet, the ACEC was directed to examine federal, state, and local taxation of telecommunications companies and services.

The ACEC testimony focused on two issues: 1) the excessive level of taxation of the telecommunications industry and its customers; and 2) the excessive administrative burden faced by the industry in complying with the numerous state and local taxes on telecommunications services.

Telecommunications industry representatives asked the Commission to recommend to Congress that state and local governments be encouraged to simplify the administrative burden on telecommunications companies. One ACEC commissioner, Californian Board of Equalization member Dean Andal, submitted a proposal that went much further. He proposed

that the Commission recommend to Congress the passage of legislation similar to the so-called federal 4R Act (“Railroad Regulatory Revitalization and Recovery Act”) to outlaw discriminatory state and local taxation of the telecommunications industry.¹⁶

However, the telecommunications industry decided not to endorse that approach. At that time, it appeared that leading state organizations like the National Conference of State Legislatures and the National Governors’ Association were committed to working at the state level to address excessive taxes on telecommunications. It remains to be seen whether the failure of the states to address the excessive tax burden on telecommunications service over the last five years will cause the industry to re-think its policy and seek Congressional action.

Looking Ahead: Excessive Telecommunications Tax Problems Will Grow Without Meaningful Reform

The recent debate over extension of the Internet Tax Non-Discrimination Act brought attention to several critical issues facing both the states and the telecommunications industry in the coming years. Most of these issues are caused by the excessive tax burdens imposed on telecommunications services by state and local governments.

From the perspective of state and local governments, revenues from excessive telecommunications taxes are an important source of revenue. State and local concerns that revenues from taxation of telecommunications services would be eroded under federal legislation to extend the moratorium on state and local taxes on Internet access led to a furious lobbying effort by state and local organizations (with the notable exception of the National Conference of State Legislatures) to defeat the legislation. The Multistate Tax Commission even published a report claiming that one version of the legislation would cause state and local governments to lose over \$20 billion in revenues – essentially every penny of taxes collected from telecommunications companies and their customers.¹⁷ The telecommunications industry was able to convince the overwhelming majority of Senators that these claims were exaggerated, and the Senate ultimately passed S.150 by a 93-3 vote.¹⁸ However, the vehemence with which state and local governments fought S.150 illustrated the importance attached to preserving excessive telecommunications taxation.

From the perspective of the telecommunications industry, the disparity in taxation between telecommunications services and other goods and services subject to state and local sales tax is not sustainable. The convergence of communications technologies is likely to render industry-specific taxes obsolete, difficult to enforce, economically inefficient and competitively non-neutral. Many of these problems would be minimized or eliminated if states:

- eliminated excessive state and local taxes on telecommunications services and taxed those services under the general sales and use tax; and
- adopted the simplifications contemplated in the Streamlined Sales and Use Tax agreement.

For example, the wireless industry is currently offering customers a host of products and services that are delivered to the customer by or through the customer’s wireless telephone or

computer equipped with a wireless modem. If the experience of Europe and Asia are any guide, the type and scope of these services will expand rapidly in the next few years. These services include, by way of example only, traditional voice transmissions, data transmissions such as text messaging, handheld web browsing capability, computer-based wireless Internet access, downloaded products like ring tones, music, wallpaper, and videos, photography, downloaded games, the ability to purchase tangible products from vending machines, the ability to pay highway tolls, and on and on.

Many of these products and services are not traditional telecommunication service, even though transmission is used to deliver the product or service to the customer. For example, ring tones and music downloads are digital products that are downloaded from a wireless company's server for a fixed fee. The same goes with electronic games and digital images like "wallpaper" for a customer's wireless phone. They are no different than digital products that are downloaded over by a customer using a "wired" Internet connection.

Two possible problems arise for the wireless industry. First, states may try to assert that any product or service downloaded through wireless transmissions is "ancillary to" or "associated with" telecommunications service and subject to telecommunications taxes. Second, companies that sell taxable voice or data transmissions as part of a package that includes non-taxable digital products could face state bundling rules that seek to make the entire transaction taxable.

Under either of these scenarios, customers that purchase a digital product from a wireless company could face a double digit tax burden. That same customer purchasing an identical product from an Internet Service Provider or other Internet-based seller would pay only the sales and use tax – if the state taxes digital products.

The resulting disparity would be exacerbated in the situation where the Internet based seller lacked nexus in the purchaser's state. In that case, many customers would end up paying no tax at all if they purchase from an Internet-based seller while paying double digit rates if purchasing from a wireless company because wireless companies have nexus in every state. This type of disparity is not sustainable in the marketplace.

It is beyond the scope of this article to discuss the emerging debate over the taxation of "Voice over Internet Protocol." Needless to say, however, that the taxation of VoIP raises some of these same issues and some additional issues as well.¹⁹ All these problems originate from the same source, however – the continued use of excessive taxes on telecommunications services by state and local governments.

Can States and Localities Reduce Reliance on Excessive Telecommunications Taxes?

As mentioned earlier, many state and local policymakers acknowledge that the antiquated and burdensome taxes on telecommunications need to be reformed. However, policymakers were constrained by the difficult fiscal situation facing the states after the dot.com bubble burst in 1999. State revenues – particularly state income tax revenues – plunged dramatically and are just now, five years later, returning to the levels enjoyed in the late-1990s.

State policymakers are not out to deliberately damage the telecommunications industry. In fact, many state economic development experts inside and outside of state and local governments recognize the importance of broadband deployment in rural and underserved areas. Many lawmakers want to help alleviate the burden of taxation on telecommunications companies and their customers because they recognize that lower taxes will spur additional demand for services, which will in turn provide companies with more money to invest in high-speed telecommunications networks.

However, some state and local governments have become dependent upon revenues from the telecommunications industry and their customers. This is especially true of local governments. Any solution that will lead to the elimination of excessive telecommunications taxes will require recognition of this revenue impact. In fact, the NCSL policy recommending the elimination of industry-specific taxes specifically recognizes the need to “*mitigate the impact on local governments.*”²⁰

The recent upturn in state revenues provides a timely opportunity to begin a phase-out of excessive telecommunications taxes. In April 2004, the NCSL, the National Association of State Budget Officers, and the Center for the Study of the States have all reported that state tax revenues are finally rebounding from the downturn of the early 2000s.²¹ This recovery of state revenues, combined with strong property tax revenue collections due to strength in the housing sector, provides additional revenue flexibility for a phase-out of excessive telecommunications taxes. Such a phase-out during times of strength in personal income, sales, and corporation income tax revenues would allow states to mitigate state and local revenue losses during a transition period where excessive taxes are phased-out.

State and local government successes with the Streamlined Sales and Use Tax Project (SSTP) may also provide another unique opportunity for states to transition away from excessive telecommunications taxes. The SSTP is a multi-state effort to simplify the administration of sales and use taxes, with a goal of minimizing burdens for sellers that operate in multiple states. The SSTP is currently working to create a system that would provide incentives for multi-state sellers that are not currently collecting sales and use taxes to do so voluntarily. In addition, state policymakers are using the SSTP as the basis for a renewed effort to convince the Congress to overturn the *Quill* “physical presence” standard through federal legislation.

If the states are successful, significant new revenues would be available to states and localities with local-option sales taxes that could allow them to eliminate excessive telecommunications taxes. In addition, by resolving nexus questions for Internet-based sellers, telecommunications companies that have nexus everywhere would be on a level playing field with Internet-based companies that sell digital products and services to customers.

In addition, the SSTP simplification provisions could substantially simplify the administrative burden of collecting state and local telecommunications taxes. The SSTP framework calls for the elimination of local tax return filing, local tax administration, and local audits. These functions would be handled by the states on behalf of their localities. Central filing and payment of local taxes to state government will significantly reduce the cost of complying with telecommunications taxes while ensuring that local revenues are collected and

remitted to local jurisdictions. There is some concern, however, that states may be inclined to exclude some telecommunications taxes from the SSTP simplification provisions.

Conclusion

States and local governments have made very little progress in reforming excessive telecommunications taxes during the last five years. However, the convergence of new communications technologies, including Voice over Internet Protocol, will put additional pressure on states and local governments to confront the unfairness inherent in current telecommunications tax policies.

Eliminating excessive tax burdens on wireless and other telecommunications services, and taxing those services under general sales and use tax provisions, would eliminate many of the most vexing problems in the state and local tax arena today. It would also have the added benefit of creating a tax policy that is aligned with state economic development objectives of providing incentives for investment in and deployment of broadband telecommunications networks. Just as the Internet generated productivity gains that were widely credited with boosting economic growth in the 1990s, tax policies that promote broadband deployment would have important economic benefits for state and local economies, especially in rural and underserved areas.

The current recovery in state revenues, combined with the possible success of the SSTP, provides a unique opportunity for state legislatures and governors to tackle telecommunications tax reform in the next legislative biennium.

FOOTNOTES

¹ Scott Paladino, “Telecommunications Tax Policies: Implications for the Digital Age.” National Governors’ Association, February 2, 2000. Available online at: <http://www.nga.org/cda/files/000202TELECOM.PDF>

² National Conference of State Legislatures. Policy adopted July 19, 2000 at NCSL Annual Meeting, Chicago, Illinois. Available online at: <http://www.ncsl.org/programs/fiscal/tcresolv03.htm>

³ Sidak, J. Gregory and Allan T. Ingraham, “Do States Tax Wireless Service Inefficiently: Evidence on the Price Elasticity of Demand.” Washington, DC: American Enterprise Institute, April 2003. Available at http://www.aei.org/publications/filter.all,pubID.20327/pub_detail.asp

⁴ Cellular Telecommunications and Internet Association. Washington, DC. Available at www.ctia.org

⁵ Federal Communications Commission, “8th Annual Commercial Mobile Radio Service Competition Report.” July 2003, page 46. Report available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-03-150A1.pdf

⁶ For an example, see the “Vermont Telecommunications Plan,” Vermont Department of Public Service, Public Comment Draft, March, 2004. Available at www.state.vt.us/psd

⁷ “50-State Study and Report on Telecommunications Taxation.” Washington, DC: Committee on State Taxation, September 14, 1999 (updated November 29, 2000).

⁸ Paladino, op.cit.

⁹ Maine HB 1420 of 2004. (budget bill).

¹⁰ City of Springfield, Oregon proposed ordinance (unnumbered). See “Opportunity to Comment: Springfield Utility Tax,” April 15, 2004. Available at: <http://www.ci.springfield.or.us>

¹¹ “Communications Services Tax Simplification Law.” Florida Statutes, Chapter 202.

¹² A full listing of local CST tax rates is available at the Florida Department of Revenue web site: http://sun6.dms.state.fl.us/dor/com_rates/CST_RateTables0604.xls

¹³ “Simplified Municipal Telecommunications Tax Act.” Illinois Compiled Statutes, 35 ILCS 636.

¹⁴ Ohio HB 95, Signed by the Governor 6/26/2003. See sections 183 and 186.

¹⁵ Landry, Keith G. and Stacey L. Sprinkle, "Proposal for State and Local Taxation of the Telecommunications Industry." Presented to the Advisory Commission on Electronic Commerce, November 15, 1999 (On behalf of Air Touch, ALLTEL, AT&T, Bell Atlantic, BellSouth, CommNet Cellular, Global Crossing, GTE, SBC, Sprint, US West, and Western Wireless) Available at:
<http://www.ecommercecommission.org/document/StateAndLocalTaxation124.doc>

¹⁶ Andal, Dean, "A Prohibition on Discriminatory Ad Valorem Taxation of Interstate Telecommunications: Encouraging Investment in Internet Infrastructure Through Equitable State Tax Treatment ." Advisory Commission on Electronic Commerce, DATE. Available at:
<http://www.ecommercecommission.org/document/104andalproposal.doc>

¹⁷ Bucks, Dan, Elliott Durbin and Ken Beier, "Revenue Impact on State and Local Governments of Permanent Extension of the Internet Tax Freedom Act." Washington, DC: Multistate Tax Commission, September 24, 2003.

¹⁸ Cline, Robert. "Critique of Multistate Tax Commission's State and Local Revenue Impact Estimates of H.R. 49. Washington, DC: Ernst & Young LLP, October 1, 2003.

¹⁹ For a discussion of these issues, see Deborah Bierbaum (Director, External Tax Policy, AT&T), "Taxing New Technologies: VoIP a Challenge to State and Local Tax Systems." Presentation to NCSL Spring Forum, April 29, 2004.

²⁰ National Conference of State Legislatures, *op. cit.*

²¹ See National Conference of State Legislatures, "State Budget Update: April 2004." Available at: <http://www.ncsl.org/programs/press/2004/040428.htm> . Also, National Governors Association and National Association of State Budget Officers, "Fiscal Survey of the States: April 2004." Available at: <http://www.nga.org/cda/files/FSS0404.pdf> . Also, Nicholas Jenny, "State Revenue Growth Gains Momentum." Albany, NY: Center for the Study of the States, May 2004. Available at:
http://stateandlocalgateway.rockinst.org/fiscal_pub/state_news/sn_reports/SFN%204-3.pdf .

Appendix A: State and Local Transaction Taxes on Wireless Service
April 1, 2004

STATE	TYPE OF TAX	RATE	NOTES
Alabama			
##	AL Cell Service Tax	6.00%	Access, interstate and intrastate
	E911	1.45%	\$.70/month
	TOTAL TRANSACTION TAX	7.45%	
Alaska			
##	Local Sales Tax	2.50%	Avg. of Juneau & Anchorage
	Local E911	1.55%	up to \$.75/month
	TOTAL TRANSACTION TAX	4.05%	
Arizona			
##	State sales (transaction priv.)	5.60%	intrastate telecommunications service
	local sales (transaction priv.)	4.70%	Avg. Phoenix & Tucson
	911	0.76%	\$.37/month
	TOTAL TRANSACTION TAX	11.06%	
Arkansas			
##	State sales tax	6.00%	Increased from 5.125% to 6% effective 3/1/2004
	Local sales taxes	2.38%	Avg. Little Rock (1.5%) & Fayetteville (3.25%)
	State USF	0.80%	Intrastate
	Wireless 911	1.03%	\$.50/mo. Statewide; local 911 - up to \$.30/mo effective 9/1/03
	TOTAL TRANSACTION TAX	10.21%	
California			
##	Local Utility User Tax	8.75%	Avg. of LA (10%) and Sacramento (7.5%)
	911	0.72%	intrastate
	PUC fee	0.11%	intrastate
	ULTS	1.10%	intrastate
	Deaf/CRS	0.30%	intrastate
	CHCF - A & B	2.20%	intrastate
	CTF	0.00%	intrastate
	TOTAL TRANSACTION TAX	13.18%	
Colorado			
##	State Sales Tax	2.90%	access and intrastate
	Local Sales Taxes	2.65%	COST- avg. of Denver & Colorado Springs
	Local sales -- RTD, CD, BS	0.80%	Denver & surrounding counties only
	911	1.02%	Up to \$.70/mo plus overrides
	USF	2.00%	Set annually based on fund status - reduced 1/03 from 2.3%
	TOTAL TRANSACTION TAX	9.37%	
Connecticut			
##	State sales tax	6.00%	Access, interstate and intrastate
	911	0.41%	\$.20/month

	TOTAL TRANSACTION TAX	6.41%	
Delaware			
##	Public Utility Gross Receipts Tax	4.25%	Access and intrastate
	Local 911 tax	1.24%	\$.60 / month
	TOTAL TRANSACTION TAX	5.49%	
District of Columbia			
##	Telecommunication Privilege Tax	11.00%	11% effective 1/1/03 -- access, inter and intra
	911	1.57%	\$.076 per month
	TOTAL TRANSACTION TAX	12.57%	
Florida			
##	State Communications services	9.17%	Access, interstate and intrastate
	Local Communications services	5.92%	Jacksonville 5.82%; Tallahassee 6.02%
	911	1.03%	up to .50/month statewide
	TOTAL TRANSACTION TAX	16.12%	
Georgia			
##	State sales tax	2.89%	4% of "access charge" -- assume \$35
	Local sales tax	2.17%	Avg. rate Fulton & Richmond Counties (3%)
	Local 911	2.58%	Atlanta -- \$1/line; Augusta -- \$1.50/line
	TOTAL TRANSACTION TAX	7.64%	
Hawaii			
##	Public service co. tax	5.89%	5.885% intrastate and access; 1.88% interstate
	PUC Fee	0.25%	.25% of intrastate
	TOTAL TRANSACTION TAX	6.14%	
Idaho			
##	Telephone service asst. program	0.17%	Set annually by PUC -- currently \$.08/mo
	Statewide wireless 911	2.07%	Local -- up to \$1.00/mo. effective 7/1/03. Boise rate.
	TOTAL TRANSACTION TAX	2.23%	
Illinois			
##	State telecom excise tax	7.00%	Access, interstate and intrastate
	Simplified municipal tax	6.50%	Avg. of Chicago & Springfield
	Wireless 911	2.07%	Chicago \$1.25/mo; others \$.75/mo
	TOTAL TRANSACTION TAX	15.57%	
Indiana			
##	State sales tax	6.00%	Access and intrastate
	Utility receipts tax	1.40%	Same base as sales tax
	Wireless 911	2.07%	up to \$1.00 set annually by board
	PUC fee	0.15%	
	TOTAL TRANSACTION TAX	9.62%	
Iowa			

##	State sales tax	5.00%	Access, intrastate
	Local option sales taxes	0.50%	Avg. of Cedar Rapids & Des Moines
	Wireless 911	1.03%	Up to .50 per number
	TOTAL TRANSACTION TAX	6.53%	
Kansas			
##	State sales tax	5.30%	intrastate & interstate
	Local option sales taxes	1.45%	Avg. of Wichita & Topeka
	USF	3.57%	4.99% of revenues x 71.5% FCC intrastate safe harbor
	911 fee		<i>Effective. 7/1/2004; \$.25 state and \$.25 county</i>
	TOTAL TRANSACTION TAX	10.32%	
Kentucky			
##	State sales tax	6.00%	Access, interstate and intrastate
	School utility gross receipts	1.50%	Avg. Frankfort (3%) and Louisville (0%)
	Lifeline support charge	1.03%	\$.50 per month Frankfort & Louisville
	Wireless 911	1.45%	\$.70 / month
	TOTAL TRANSACTION TAX	9.98%	
Louisiana			
##	State sales tax	3.00%	Access, interstate and intrastate
	Wireless 911	1.39%	New Orleans \$.85/month; Baton Rouge \$.50/mo.
	TOTAL TRANSACTION TAX	4.39%	
Maine			
##	State sales tax	5.00%	intrastate
	911 tax	1.03%	\$.50/month eff. 7/1/03
	USF	0.50%	
	TOTAL TRANSACTION TAX	6.53%	
Maryland			
##	State sales tax	5.00%	"mobile telecommunications service"
	Local telecom excise	0.00%	8% in PG county; 0% in Baltimore & Annapolis
	State 911	0.52%	\$.25/mo. Effective 10/1/03
	County 911	1.55%	Up to maximum of \$.75/mo eff. 10/1/03
	TOTAL TRANSACTION TAX	7.07%	
Massachusetts			
##	State sales tax	5.00%	interstate and intrastate
	Wireless 911	0.62%	\$.30/month
	TOTAL TRANSACTION TAX	5.62%	
Michigan			
##	State sales tax	6.00%	interstate and intrastate
	Wireless 911	1.07%	\$.52/month
	TOTAL TRANSACTION TAX	7.07%	
Minnesota			
##	State sales tax	6.50%	Interstate and intrastate
	Local sales tax	0.50%	up to 1.0% -- COST avg. of Minneapolis & St Paul

	911	0.83%	Max \$.40/mo. effective 7/1/03
	Telecom access MN fund	0.28%	Up to \$.20 set by PUC -- currently \$.13/mo
	TOTAL TRANSACTION TAX	8.10%	
Mississippi			
##	State sales tax	7.00%	Access, interstate and intrastate
	Wireless 911	2.07%	\$1.00 per month per line
	TOTAL TRANSACTION TAX	9.07%	
Missouri			
##	State sales tax	4.23%	Access and intrastate
	Local sales taxes	2.65%	COST method -- avg. of Jeff City & St. Louis
	Local license tax	4.25%	Jefferson City (8.5%) and Clayton (8%) only cities to impose
	TOTAL TRANSACTION TAX	11.12%	
Montana			
##	Telecom excise tax	3.75%	Access, interstate and intrastate
	911 & E911 tax	1.03%	\$.50 per number per month
	TDD tax	0.21%	\$.10 per number per month
	TOTAL TRANSACTION TAX	4.99%	
Nebraska			
##	State sales tax	5.50%	Access & intrastate
	Local sales tax	1.50%	up to 1.5%
	State USF tax	6.95%	intrastate service revenue
	Wireless 911	1.03%	\$.50 per month
	TRS	0.14%	\$.07 per month effective 1/1/03
	TOTAL TRANSACTION TAX	15.13%	
Nevada			
##	Local franchise / gross receipts	0.62%	2% of first \$15 intrastate revenues
	Local 911 tax	0.52%	up to \$.25 per month -- imposed by counties
	State deaf relay charge	0.17%	\$.08 per month -- effective 7/1/03
	TOTAL TRANSACTION TAX	1.14%	
New Hampshire			
##	Communication services tax	7.00%	Access, interstate and intrastate
	911 tax	0.87%	\$.42 per month per CMRS number
	TOTAL TRANSACTION TAX	7.87%	
New Jersey			
##	State sales tax	6.00%	Access, interstate and intrastate
	TOTAL TRANSACTION TAX	6.00%	
New Mexico			
##	State gross receipts (sales) tax	5.00%	5% intrastate; 4.25% interstate
	Local gross receipts taxes	1.25%	Avg. Santa Fe & Albuquerque
	Wireless 911	1.05%	\$.51 per month per subscriber
	TRS surcharge	0.33%	intrastate
	TOTAL TRANSACTION TAX	7.63%	

New York

##	State sales tax	4.25%	Intrastate and monthly access
	Local sales taxes	4.00%	COST method -- avg. of NYC & Albany
	MCTD sales tax	0.13%	NYC - .25%; Albany 0% (COST)
	State excise tax (186e)	2.50%	mobile telecom service -- includes interstate
	MCTD excise/surcharge (186e)	0.30%	NYC & surrounding counties - .6%; Albany 0%
	Local utility gross receipts tax	1.51%	NYC -- 86% of 2.36%; Albany 1%
	State wireless 911	2.48%	\$1.20 per month
	Local wireless 911	0.62%	\$.30 per month -- NYC & selected cities
	MCTD surcharge (184)	0.07%	NYC .13%; Albany -- no tax
	NY franchise tax (184)	0.38%	
	School district utility tax	0.00%	Up to 3% -- no tax in NYC and Albany
	TOTAL TRANSACTION TAX	16.23%	

North Carolina

##	State sales tax	6.00%	Access, interstate and intrastate
	Wireless 911	1.65%	.80 per month
	TOTAL TRANSACTION TAX	7.65%	

North Dakota

##	State sales tax	5.00%	Access and intrastate
	Local sales taxes	1.25%	Avg. Fargo & Bismarck; includes Cass County
	State gross receipts tax	2.50%	interstate and intrastate
	Local 911 tax	2.07%	up to \$1.00 / month
	TRS	0.12%	Up to \$.11/mo -- currently \$.06
	TOTAL TRANSACTION TAX	10.94%	

Ohio

##	State sales tax	6.00%	Access, interstate and intrastate
	Local sales taxes	1.63%	County & transit taxes -- avg. Columbus & Cleveland
	TOTAL TRANSACTION TAX	7.63%	

Oklahoma

##	State sales tax	4.50%	Access, interstate and intrastate
	Local sales taxes	3.65%	Avg. of OK City & Tulsa
	911 TAX	1.03%	\$.50 per line
	USF	0.40%	intrastate
	TOTAL TRANSACTION TAX	9.58%	

Oregon

##	911 tax	1.55%	\$.75 per month
	TDD / low income subsidy	0.72%	Up to \$.35/month -- currently \$.13/mo
	TOTAL TRANSACTION TAX	2.27%	

Pennsylvania

##	State sales tax	6.00%	Access, interstate and intrastate
	State gross receipts tax	5.00%	Access, interstate and intrastate
	Local sales tax	0.50%	Philly and Pittsburgh @ 1% -- other locals 0%

Statewide wireless 911	2.07%	\$1.00 per month – effective 4/1/04
TOTAL TRANSACTION TAX	13.57%	

Rhode Island

## State sales tax	7.00%	Access, interstate and intrastate
Gross receipts tax	5.00%	Access, interstate and intrastate
Wireless 911	2.07%	\$1.00 per month
TOTAL TRANSACTION TAX	14.07%	

South Carolina

## State sales tax	5.00%	Access, interstate and intrastate
Local sales tax	0.00%	Up to 2% -- no tax in Greenville & Rockland County
Municipal license tax	0.30%	.3% of monthly recurring charge (max 0.75% on 1/1/04)
911 tax	1.20%	\$.58 / month
TOTAL TRANSACTION TAX	6.50%	

South Dakota

## State sales tax	4.00%	access, interstate and intrastate
State gross receipts tax	4.00%	wireless only effective 7/1/03
local option sales tax	2.00%	up to 2% -- COST methodology
911 excise	1.55%	up to \$.75 per month
TRS fee	0.31%	\$.15 per month
PUC fee	0.15%	intrastate receipts
TOTAL TRANSACTION TAX	12.01%	

Tennessee

## State sales tax	7.00%	Access, interstate and intrastate
Local sales tax	2.50%	Shelby & Davidson counties
911 tax	2.07%	Up to \$2.00 statewide -- \$1.00 currently imposed
TOTAL TRANSACTION TAX	11.57%	

Texas

## State sales tax	6.25%	Access, interstate and intrastate
Local sales tax	2.00%	Avg. Austin & Houston
Telecom Infrastructure Fund	1.25%	statewide on sales tax base
Wireless 911 tax	1.03%	\$.50 per month
Texas USF	3.60%	statewide on sales tax base
Equalization surcharge	0.06%	intrastate long distance
TOTAL TRANSACTION TAX	14.19%	

Utah

## State sales tax	4.75%	Access and intrastate
Local sales taxes	1.85%	SLC rates used
Local utility wireless	2.07%	up to \$1.00 per month -- SLC rate used
911 tax	1.10%	\$.53/month
Poison Control	0.14%	\$.07/month
State USF	0.34%	intrastate revenues
TOTAL TRANSACTION TAX	10.25%	

Vermont

##	State sales tax	6.00%	Access, interstate and intrastate
	State USF	1.27%	Same
	TOTAL TRANSACTION TAX	7.27%	

Virginia

##	Local utility users tax	6.20%	Avg. of Richmond (\$3.00/mo.) & Virginia Beach(\$3.00/mo)
	Wireless 911	1.55%	\$.75/month
	TOTAL TRANSACTION TAX	7.75%	

Washington

##	State sales tax	6.50%	Access, interstate and intrastate
	Local sales tax	1.90%	Avg. Olympia & Seattle
	B&O / Utility Franchise -- local	6.19%	Olympia & Seattle avg.
	911 -- county excise	0.41%	\$.20/month effective 1/1/03
	911 -- state	1.03%	\$.50/month effective 1/1/03
	TOTAL TRANSACTION TAX	16.04%	

West Virginia

##	Wireless 911	1.94%	\$.94 per month
	TOTAL TRANSACTION TAX	1.94%	

Wisconsin

##	State sales tax	5.00%	Access, intrastate and interstate
	Local sales tax	0.55%	Avg. of Milwaukee & Madison
	TOTAL TRANSACTION TAX	5.55%	

Wyoming

##	State sales tax	4.00%	access and intrastate
	Local sales tax	1.00%	avg. of Cheyenne & Laramie
	TRS	0.12%	Up to \$.25/month -- \$.06 currently
	USF	4.00%	access and intrastate
	911 tax	1.55%	\$.75/mo statewide effective 7/1/03
	TOTAL TRANSACTION TAX	10.67%	

ARPU=**\$48.40**

Source: Committee on State Taxation, 50-State Study and Report on Telecommunications Taxation, Nov. 29, 2000
Updated 2004 by Scott Mackey, Kimbell Sherman Ellis using state statutes.