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STATE TAXATION OF INTERSTATE TELECOMMUNICATIONS SERVICES

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

JUNE 13, 2006

Serial No. 109–120

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

28–199 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
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STATE TAXATION OF INTERSTATE TELECOMMUNICATIONS SERVICES

TUESDAY, JUNE 13, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:07 p.m., in Room 2141, Rayburn House Office Building, the Honorable Chris Cannon (Chairman of the Subcommittee) presiding.

Mr. CANNON. Good afternoon, ladies and gentlemen. This hearing of the Subcommittee on Commercial and Administrative Law will now come to order. I apologize for being a few minutes late. We just had a vote.

Every month, we'll receive at least one bill from a telecommunications company and some receive more. I know I do. These bills are for our home phone, cell phone, cable, DSL, cable Internet, and other services. Whenever I look at my bill, one thing I keep thinking is how much do I have to pay in taxes just to be able to communicate with others.

In our increasing mobile society, communications services hold us together. These services allow us to keep in touch with our families while we are away from home. They allow us to communicate with our kids when they leave home. I personally e-mail or text message my son. It turns out to be the most convenient way to get more than three words out of him. And not often and they sometimes are "u" instead of "y-o-u," but this is what life is about. With the touch of a button, we can contact them to find out how they are, find out how they are doing and then they ask us for more money. I was thinking we might be able to establish a filter for that.

The innovations and expansion of communications have helped us become a more productive society and fueled our ability to lead the global economy. We should be finding ways to encourage innovation, not block it with excessive and discriminatory taxes. Higher taxes ensure that we will see less of the taxed service. Taxing telecommunications services stymies technological process by creating disincentives to purchase these services.

Communication taxes have been applied piecemeal by local State and Federal Government over a long period of time, and many of these taxes were created while we still had essentially one company running communications in America. We now have competition from wireless, cable and others, but we still have not moved

away from a complex tax system, even though we have a dynamic competitive industry.

Taxes on communications services are a jumble. The tax rates on communications are about at the point where these taxes are approaching the level of "sin" taxes. We want to encourage people to use communications, and we want all people to be able, not move the cost beyond what the poor amongst us can afford. The taxes fees and surcharges on a phone bill include: Relay center surcharges public right-of-way fees, gross receipts taxes, 911 fees, universal service funds, cost recovery surcharges, State sales tax, local sales tax and additional local taxes.

It is easy to understand what some of these taxes fund such as the 911 fees, but other fees are not comprehensible such as the cost recovery surcharge found on the Virginia Verizon bill.

In 2004, the regressive rate of State and local taxation on telecommunications services was 14.17 percent. States and localities have acknowledged there is a problem and that we need to reform. Today, we'll discuss this problem and what can be done to limit excessive taxation on telecommunications services and providers. This is just the beginning of the discussion. I expect future hearings on this issue, and I look forward to the testimony of the panel.

Now without objection, the Chair will be authorized to recess the Committee at any point. Hearing none, so ordered.

I further ask unanimous consent that Members have 5 legislative days to submit written statements and statements by interested parties for inclusion in today's record. Without objection, so ordered.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Good afternoon ladies and gentlemen; this hearing of the Subcommittee on Commercial and Administrative Law will now come to order.

Every month we all receive at least one bill from a telecommunications company, and some receive more, I know I do. These bills are for our home phone, cell phone, cable, DSL, cable internet, and other services. Whenever I look at my bill, the one thing I keep thinking is: How much do I have to pay in taxes, just to be able to communicate with others?

In our increasingly mobile society, communications services hold us together. These services allow us to keep in touch with our families while we are away from home. They allow us to communicate with our kids when they leave home. With the touch of a button, we can contact them to find out how they are, find out what they are doing and for them to ask us for more money. Maybe we could establish a filter for this use!

The innovations and expansion of communications have helped us become a more productive society and fueled our country's ability to lead the global economy. We should be finding ways to encourage innovation, not block it with excessive and discriminatory taxes. Higher taxes ensure that we will see less of the taxed service. Taxing telecommunications services stymies technological progress by creating disincentives to purchase these services.

Communication taxes have been applied piecemeal by local, state, and federal government over a long period of time. Many of these taxes were created when we still had essentially one company running telecommunications in America. We now have competition from wireless, cable and others, but we still have not moved away from a complex tax system even though we have a dynamic and competitive industry.

Taxes on communications services are a jumble. The tax rates on communications are about at the point where these taxes approach the level of "sin" taxes. We want to encourage the use of communications by ALL people, not move the cost beyond what the poor amongst us can afford.

The taxes, fees and surcharges, on a phone bill include: relay center surcharges, public right-of-way fees, gross receipts taxes, 911 fees, universal service funds, cost recovery surcharges, state sales tax, local sales tax and additional local taxes. It is easy to understand what some of these taxes fund, such as the 911 fees. But other fees are not comprehensible such as the cost recovery surcharge found on a Virginia Verizon bill.

In 2004 the regressive rate of state and local taxation on telecommunications services was 14.17 percent. States and localities have acknowledged there is a problem and that we need reform. Today, we will discuss this problem and what has been done to limit excessive taxation on telecommunications services and providers.

This is just the beginning of the discussion. I expect future hearings on this issue, and I look forward to the testimony of the panel.

Without objection, the Chair will be authorized to recess the committee at any point. Hearing none, so ordered.

I further ask unanimous consent that Members have 5 legislative days to submit written statements and statements by interested parties for inclusion in today's record. Without objection, so orderd.

I now yield to Mr. Watt, the Ranking Member of the Subcommittee, for an opening statement.

Are there any Members wishing to make opening remarks?

Mr. CANNON. I'd now like to recognize Mr. Watt, the Ranking Member of the Subcommittee, for an opening statement.

Mr. WATT. Thank you, Mr. Chairman. Today's hearing and markup consider tax policies of significant importance to the effect that industries and also to the States and local governments that levy taxes and rely on revenues from those taxes. At the hearing on H.R. 1396, which we understand are marking up today one of the witnesses testified "it is axiomatic that if had Congress intervenes in State and local taxation in a manner that establishes a favored group of taxpayers, then other taxpayers who feel that they are in the same position will come forward seeking the same favorite treatment."

Against the backdrop of any Federal legislation seeking to curtail or limit the States' taxing authority, are structural issues of federalism and constitutional considerations including due process, commerce clause, and equal protection. There are also very basic bread and butter issues: Funding of schools, revitalizing post hurricane devastated areas and paving streets. Things of that kind.

That said, I think that it is important that we take a serious look at the current state of State and Federal and local tax structures and the way they affect the telecommunications industry and the consumer. I believe the change is necessary in this area. I am also respectful of State sovereignty and hope that this and subsequent hearings will enlighten us on what role Congress can constructively make in assuring that the principles of tax efficiency, competitive neutrality and tax equity on which all stakeholders seem to agree are reflected in concrete policies and practices.

One of my particular concerns about the discriminatory application of State and local taxes on the telecommunications industry is the disproportion of burdens such taxes may have on low fixed and middle income families and communities of color. As Chair of the Congressional Black Caucus, I have endeavored to support legislative initiatives that close the disparities that exist in various facets of American life. Telecommunications is no different. Indeed, in light of the pervasiveness and rapidity of technological advances, I believe that ensuring policies that promote growth, competition and access are fundamental to citizens of all economic background.

Understand that we will hear from additional stakeholders at subsequent hearings. For example, a U.S. conference of mayors and other local entities not represented here today may have another variations on these issues and certainly a different perspective. And because I have always wanted to hear all the perspectives, I will certainly be supporting additional hearings so that everybody can express themselves.

Thank you again, Mr. Chairman, for convening the hearing. I look forward to additional hearings on this issue and thank the witnesses in advance for their testimony, and I yield back the balance of my time.

Mr. CANNON. Thank you. I always appreciate your thoughtful comments. I want to apologize for the background communications while you are speaking. Just for the convenience of witnesses, we have a camera that is associated with whoever thinks he's going to be the first witness, and I am not sure who that is. Is that you, Mr. Rauschenberger? Okay. Great.

Then, actually, for odd reasons we are going to introduce Mr. Mackey first and then we'll move across the dais. We'll start with you as the first witness.

Scott Mackey is an economist and partner at Kimbell Sherman Ellis. He's worked with the States and major wireless telecommunications companies in their efforts to conform to the Mobile Telecommunications Sourcing Act. Mr. Mackey has been the chief economist for the National Council State Legislatures and represented NCSL on the Steering Committee on the NTA Telecommunications and Electronic Commerce Tax Project.

Mr. Mackey earned his undergraduate degree in economics from Middlebury College and his MBA from the University of Colorado. Mr. Mackey, thank you for your appearance here today. We look forward to your testimony.

Our next witness is David Quam, the Director of the Office of the State and Federal Relations for the National Governors Association. He works closely with the governors of Washington D.C. Representatives and the NGA's standing committees.

Prior to joining the NGA, Mr. Quam was the Director of International Affairs and General Counsel for the International Anti-Counterfeiting Coalition, Inc. He was also Majority Counsel for the U.S. Senate Subcommittee on the Constitution, Federalism and Property Rights for the Committee on the Judiciary.

And Mr. Quam received his undergraduate degree from Duke University and his J.D. from Vanderbilt University, and we appreciate you coming to testify today.

Our next witness is Stephen Kranz, Tax Counsel for the Council on State Taxation. He's responsible for following and responding to State tax developments around the country for COST. Mr. Kranz is a regular contributor to COST's publications and COST's State Study and Report on Telecommunications Taxation. He's also a frequent speaker on State and local tax topics around the country.

Prior to joining COST, Mr. Kranz established the Office of the Chief Counsel while working at the District of Columbia's Office of Tax and Revenue. He spent 6 years as a trial attorney in the Honors Program of the United States Department of Justice, Tax Division and he is the current chair of the District of Columbia Bar's

State and Local Tax Committee. And Mr. Kranz, welcome. We appreciate your time.

Our final witness is, or in this case, the first witness today is Senator Steven Rauschenberger. Senator Rauschenberger was elected to the Illinois Senate in 1992. He is now the assistant Republican leader and specializes in eliminating State and local discriminatory tax schemes, as well as immigration, Medicaid, and welfare reform.

Would you like to come to Utah? Take some of the arrows for the next few days?

He is President of the National Counsel of State Legislatures through August of this year and previously served as co-chair of NCSL's Executive Committee Taskforce on State and Local Taxation of Telecommunications and Electronic Commerce.

During his time in office, Senator Rauschenberger has been an advocate in the interests of taxpayers.

Senator Rauschenberger, we thank you for coming here to Washington to discuss these issues with us today. It is nice to see you today and appreciate your involvement in the topic, which is very important. I extend to each of you my warm regards and appreciation for your willingness to participate in today's hearing. In light of the fact that your written statements will be included in the hearing record, I request that you limit your oral remarks to about 5 minutes.

We have a lighting system that starts with a green light that goes for 4 minutes, then it turns yellow and at 5 minutes it turns red. It is my habit to tap my pencil just to get a little bit of attention at that point. Sometimes we have a lot of people in these hearings, maybe people who are still wandering back from votes. When that's the case, we try to keep it more tightly at 5 minutes because everybody needs a chance to ask questions, but this is not a fixed thing, unless people ask questions that I don't like then I get tougher with the gavel. That's not true, we have never had a problem with that, I don't think.

On the other hand, we would like to explore a bit in discussion and with questions, and so to finish up your thoughts, we'll move on. And after you've presented your remarks I will, based upon the time of arrival of Members of the Committee will be offered the opportunity to ask questions.

Now, pursuant to the Chairman of the Judiciary Committee, I need to ask you to stand and raise your right hand and take the oath.

[Witnesses sworn.]

Mr. CANNON. The record should reflect that all of the witnesses answered in the affirmative.

You may be seated.

And then we are going to start with you, Mr. Rauschenberger; is that not correct? You are recognized for 5 minutes.

STATEMENT OF STEVEN RAUSCHENBERGER, ASSISTANT REPUBLICAN LEADER, ILLINOIS SENATE, AND PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES, SPRINGFIELD, IL

Mr. RAUSCHENBERGER. Good afternoon, Chairman Cannon, and Ranking Member Watt and Members of the Subcommittee on Commercial and Administrative Law. I truly appreciate the opportunity to be here to testify before you today and I am very appreciative of the fact that you are taking up what I think is a very important issue to my children, to my constituents, and ultimately, to the United States.

I am State Senator Steve Rauschenberger from Illinois. I am President this year of the National Conference of State Legislatures. With me today in the audience is State Senator Leticia Van de Putte of Texas and NCSL's President-elect. Senator Van de Putte and I have made telecommunications tax reform one of NCSL's major priorities and I am pleased that she could join me here today to see the testimony and see how I did in my first testimony before the Judiciary Committee.

New technology convergence and competition in telecommunications makes it critical to simplify and reform State and local taxes to ensure a level playing field and to enhance economic development and avoid discrimination among telecommunications providers.

For almost 100 years until 1984, telephone service was a highly regulated industry in which consumers did not have a choice of provider. Phone companies were subject to tax under statutes applicable to public utilities, and such taxes in the form of gross receipts, franchise and other industry. Specific taxes were passed on to customers as part of the regulatory rate setting scheme. Many monopoly phone companies had no reason to, and normally did not, oppose these taxes. In the 1990's, many States began efforts to deregulate local markets and to open these markets to competition to improve consumer choice and, hopefully, lower prices. In the Telecommunications Act of 1996, Congress further opened local markets. In most States, the deregulation of the industry was not accompanied by corresponding elimination, simplification, or restructuring of the old monopolistic tax system that's based on silos and technology. Innovation and convergence of existing technologies are radically expanding what telecommunication services are; blurring the distinction between telephone and Internet services; between cable wireless and satellite communications; between long distance and local service; and, between telephone and other forms of communications.

Many of these new technologies are capable of delivering telecommunications or telecommunications-like services. As a result, similar services can be delivered by networks that are taxed very differently and for a growing number of new technologies, these services are free from State and local taxation. This uneven governmental treatment at the State and local level, while not intentional, has led to competitive barriers, discouraged market investment and infrastructure development that is crucial to the future and impacted the rollout of advance telecommunications service throughout the United States.

Imposing these higher tax burdens on telecommunications services provided by some telecommunication providers while imposing lower or even no tax burdens on similar services sold by nontraditional providers, places governments in the position of picking winners and losers in the market place.

Under the legacies of the former monopolistic structure, State and local tax burdens on telecommunications companies and their customers are significantly above those imposed in other types of industries and service. The Council on State Taxation, COST, found that the average rate of State and local taxes for telecommunications services was around 14.1 percent, compared with only an average of about 6 percent for general business taxes.

No reasonable policy maker can continue to justify this discriminatory tax regime on communication services. At a time when we talk about how important it is to have everyone ubiquitously connected to the network and to have access to high speed communications, for us to allow a—a discriminatory tax regime is not realistic.

You need to know that NCSL has been working for almost a decade on reforming State telecommunication taxes. The three principles that I want to highlight that we believe and have pressed hard for are tax efficiency by State and local governments; we've pushed hard for competitive neutrality in State and local public policy; and, for tax fairness between technologies.

Telecommunications tax reform is much easier said than done. States face a tremendous barrier in overcoming inertia, in persuading local governments in municipalities to accept the risks of a new tax regime which may lower rates but broaden their tax base. But if we are going to have the kind of advanced deployment of telecommunication services in networks that we all believe are the future for the United States, we are going to have to take those kind of risks.

I think the fact that this Subcommittee is taking this issue up, helps provide impetus and encourages State and local decision makers to stay focused on the task. The threat over time that there may be deadlines from the Federal Government serves as a stimulus which will help bring State and local government decision makers together.

You know, I've worked thoughtfully and watched the telecommunications industry cooperate with my task force for nearly a decade as we tried to build consensus and we have had some progress. I am going to get into it in questions where States had acted on their own.

But I don't think we have another decade to thoughtfully wait for enlightened State public policy makers to find their way on their own. So the very fact that you're convening this, that you are discussing this, you are making people aware that the Congress is concerned about equity and taxation, are making sure we send the right kind of messages. I'll be happy to answer any questions you have.

Thank you.

[The prepared statement of Mr. Rauschenberger follows:]

PREPARED STATEMENT OF SENATOR STEVEN RAUCHENBERGER

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

TESTIMONY OF
SENATOR STEVEN RAUSCHENBERGER
ASSISTANT REPUBLICAN LEADER
ILLINOIS SENATE
PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES

ON BEHALF OF THE
NATIONAL CONFERENCE OF STATE LEGISLATURES

REGARDING
STATE TAXATION OF INTERSTATE TELECOMMUNICATIONS SERVICES

BEFORE THE
SUBCOMMITTEE ON ADMINISTRATIVE AND COMMERCIAL LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 13, 2006

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 13, 2006

TESTIMONY OF SENATOR STEVEN RAUSCHENBERGER,
ASSISTANT SENATE REPUBLICAN LEADER, ILLINOIS
PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES

Chairman Cannon, Ranking Member Watt and members of the Subcommittee on Commercial and Administrative Law, I appreciate the invitation to testify before you today on behalf of the National Conference of State Legislatures (NCSL). I am Steve Rauschenberger, Assistant Republican Leader of the Illinois Senate and President of NCSL. The National Conference of State Legislatures is the bi-partisan organization representing every state legislator from all fifty states and our nation's commonwealths, territories, possessions and the District of Columbia.

I am pleased to have the opportunity to speak to you about the current status of state and local taxation of telecommunications services and the need for government at all levels to address telecommunications tax reform. The elimination of boundaries, new technologies and increased convergence and competition in telecommunications makes it critical to simplify and reform state and local taxes to ensure a level playing field, to enhance economic development, and to avoid discrimination among telecommunications providers. Consumers' telecommunications choices must not be made on the basis of outdated tax regimes.

State and Local Taxation of Telecommunications – The Current Regime

For almost 100 years, until 1984, telephone service was a highly regulated industry in which consumers did not have a choice of a provider. If they wanted phone service, consumers had one choice, the monopoly provider in their service area and in most cases that provider was AT&T, the parent company of the Bell System. Phone companies were regulated by the state public service or utility commissions. These providers were subject to tax under statutes applicable to "public utilities" and such taxes in the form of gross receipts, franchise and other industry-specific taxes were passed on to consumers as part of the regulatory rate setting process.

The monopoly phone companies normally did not oppose tax increases by state and local governments. The tax increase was passed onto the consumer and the phone company did not have to worry about the consumer looking for a cheaper alternative provider as there was no competition. A state and local government could tax telecommunications at a rate higher than any other business with little or no outcry from unsuspecting constituents, "it was just that damn phone company raising rates again!!!"

In 1984, with the settlement of the antitrust suit brought by the United States against AT&T and Bell Laboratories, the age of telecommunications monopolies started to unravel. AT&T was divested of its local operating companies and faced competition for long distance service. However, local exchange business was still operated as a monopoly by the eight Baby Bells (of which, there will soon only be three.)

In the 1990's many states began efforts to deregulate local markets and open these markets to competition. In the Telecommunications Act of 1996, Congress further opened local markets by allowing the regional Bell companies to enter into long distance service when the local market was sufficiently competitive. In most states, the deregulation of the industry was not accompanied by corresponding elimination, simplification, or restructuring of taxes that have historically been levied on regulated companies.

The primary goal of the federal Telecommunications Act of 1996 was to open telecommunications markets to competition. Ten years later competition exists but not solely as a result of the 1996 Act or similar state efforts. Competition also has occurred as a result of increased consumer access to wireless and cable communications services and the ability of consumers to communicate over the Internet through Instant Messaging, e-Mail, and now Voice over Internet Protocol (VOIP).

Innovation and convergence of existing technologies are radically expanding telecommunications services, blurring distinction between telephone and Internet services; between cable, wireless and satellite; between long distance and local service; and between telephone and other forms of communications.

Many of these new technologies are capable of delivering telecommunications services but do not fit within the definitions of the traditional regulatory framework for telecommunications. As a result, similar services can be delivered via networks that are taxed differently, and for a growing number of technologies, these services are free of state and local taxation. This uneven governmental treatment, while not intentional, has led to competitive barriers, discouraged investment in infrastructure development by traditional providers, and impacted the roll out of advanced telecommunications services. Imposing these higher tax burdens on telecommunications services provided by some telecommunications providers, while imposing lower and even no tax burdens on similar services sold by non-traditional providers, places governments in the position of picking winners and losers in the marketplace.

One of the legacies of the former monopolistic structure is that state and local tax burdens on telecommunications companies and their customers are significantly above those imposed on most other types of industries and services. In its 2004 State Study and Report on Telecommunications Taxation, the Council on State Taxation (COST) found that the average rate of state and local taxes on taxes for telecommunications services was 14.17 percent, compared to only 6.12 percent for taxes on general business.

This discrepancy between taxes on telecommunications services and general business amounts to discriminatory taxation of telecommunications. State and local governments will sometime levy discriminatory taxes on products that society would like to discourage consumption for the general good. Most states and local governments levy such discriminatory taxes on the purchase of alcohol and tobacco. These taxes are usually referred to as "sin taxes."

I believe we all can acknowledge that telecommunications and advanced technology is a vital component of this country's economic growth and stability. Why then does government want to treat the use of telecommunications services as if it was harmful to the overall economic well being and welfare of society? No reasonable policymaker can continue to justify this discriminatory tax regime on communications services. State and local governments can no longer hide behind the smokescreen that transactional taxes on telecommunications services are on the provider. We can no longer hide from the fact that discriminatory taxation of telecommunications is a direct tax on our constituents.

Collection and Administration of Telecommunications Taxes

Another discriminatory throwback to the monopoly age of telecommunications is the collection and administration of telecommunications transactional taxes. Telecommunications providers are subject to taxation in almost 14,000 jurisdictions and in 2004, according to the COST Report, filed almost 48,000 returns in many cases directly to these 14,000 jurisdictions. The administrative and collection burden forces telecommunications providers to incur substantial expenditures to satisfy compliance and systems requirements, resulting in higher costs of service for consumers without any corresponding benefit to state or local governments.

NCSL Telecommunications Tax Reform Principles

In 1999, the Executive Committee of the National Conference of State Legislatures established the Task Force on State and Local Taxation of Telecommunications and Electronic Commerce, which I had the pleasure to co-chair until last year, to review the current state and local taxation regimes on telecommunications and to formulate a set of principles for how state legislatures should address the simplification and modernization of taxes on telecommunications services. The Task Force also was instrumental in working with governors, tax administrators and the private sector in developing the Streamlined Sales and Use Tax Agreement.

The Task Force approved a set of principles for telecommunications tax reform that have been unanimously endorsed by the NCSL Executive Committee:

Tax Efficiency: State and local taxes and fees imposed on telecommunications services should be substantially simplified and modernized to minimize confusion and ease the burden of administration on taxpayers and governments.

Competitive Neutrality: State and local transaction taxes and fees imposed on telecommunications services should be applied uniformly and in a competitively neutral manner upon all providers of telecommunications and similar services, without regard to the historic classification or regulatory treatment of the entity.

Tax Equity: Under a uniform, competitively neutral system, industry-specific telecommunications taxes are no longer justified.

Tax Fairness: With the blurring of distinctions between various services and technologies, state and local governments must strive to set tax burdens on telecommunications services, property and providers that are no greater than those tax burdens imposed on other competitive services and the general business community.

Local Government Impacts: States need to include provisions to mitigate potential local government revenue impacts associated with telecommunications tax reform.

Economic Development: States need to simplify, reform and modernize state and local telecommunications tax systems to encourage economic development, reduce impediments to entry, and ensure access to advanced telecommunications infrastructure and services throughout the states.

State Sovereignty: NCSL will continue to oppose any federal action or oversight role which preempts the sovereign and Constitutional right of the states to determine their own tax policies in all areas, including telecommunications.

Transactional taxes and fees imposed on telecommunications services, including the collection and administration of those taxes and fees, should be simplified and modernized to minimize confusion, remove market distortion and eliminate discrimination regarding the taxability of telecommunications services. Let us not forget that these transactional taxes and fees as well as the cost of collection are not paid by the telecommunications provider but in almost all cases passed onto consumers, thus raising the costs of telecommunications services and quite possibly widening the so-called "digital divide."

In addition, discriminatory taxes on telecommunications services have a more regressive impact on low income taxpayers. Obviously, the more services a consumer chooses from a telecommunications provider, the higher the taxes that consumer will have to pay. By maintaining the current discriminatory tax regime, government is increasing the price range for many communications services by an average 15 percent nationwide and thus placing them out of the financial reach of many low income taxpayers.

Telecommunications Tax Reform – Easier Said Than Done

Over the past few years, NCSL has made telecommunications tax reform a major priority for states to consider. We have spent much time educating state policymakers on the need to simplify and modernize taxes on telecommunications services as well as the benefits in doing so. While I would like to report that our efforts have met with great success, the fact that we are having this hearing today points to the slow progress that has been made.

One area where we have seen moderate success has been in the reduction of returns that are filed by telecommunications providers. The 2004 COST Report shows that the number of returns dropped from almost 67,000 in 2001 to almost 48,000 in 2004. This reduction of returns can be attributed to state legislative efforts in Florida, Ohio, Tennessee, Utah and Illinois. This reduction while noteworthy is still too high compared with the returns filed by general business, 7,500.

Unfortunately, progress in rate reform has even been slower. Only a handful of states have addressed rate reform to some degree in the last few years, the most recent being Kentucky, Missouri and Virginia.

Earlier this year, the Virginia General Assembly completed action on efforts that began in 2002 to reform telecommunications taxes. Prior to this action the average tax rate in Virginia on telecommunications services was 29.77 percent, which was 15 percent higher than the national average. The Virginia legislation, H.B. 568, sponsored by Delegate Sam Nixon, lowers the combined state and local rate to 5 percent and extends the tax to communications services previously not taxed such as satellite and VOIP. The Virginia legislation also reduces the number of returns by having the providers remit the funds collected to the state for distribution to local governments. NCSL is using the Virginia legislation and experience in enacting the reform as a model for other states to consider.

However, the slowness in progress is not simply due to a lack of desire on the part of policymakers to reform telecommunications taxes. As the sponsors of the Virginia legislation will tell you, "Telecom Tax Reform is Easier Said Than Done." It took Virginia policymakers five years to enact reform. As we all know, tax reform of any kind does not happen in a vacuum. While there are many stakeholders who will benefit from tax reform, others, e.g. new providers of communications services and many local government officials, will work to defeat any legislative effort to reform tax rates. Another obstacle has been the lack of public arousal over discriminatory telecommunications taxes. This is partially due to the monopoly legacy, many consumers think it is still the phone company just raising rates again. I will briefly discuss the obstacles to tax reform.

New Provider Opposition

As I discussed, there are providers of communications services, who because of the medium used to deliver the service, may not be taxed at the same level as the more traditional landline, wireless and cable providers, if they are taxed at all. These new providers see their tax status as a competitive edge and will work to stop any effort in state legislatures that would increase or tax their service to achieve competitive neutrality. For example, the satellite industry was successful in 2005 in Virginia in bringing consideration of the telecommunications tax reform legislation to a halt. The satellite providers notified their customers that the General Assembly wanted to place a tax of 5 percent on their satellite television service. Obviously, satellite providers failed to mentioned to their customers that their phone bill, whether wireless or landline, could decrease as much as 24 percent by the enactment of the same legislation.

While some VOIP providers presently collect state and local taxes on telecommunications, primarily those operated by a traditional carrier, pure-play VOIP providers, e.g. Vonage, only collect state and local taxes for the state in which they are located. If you have VOIP service through Vonage, and you are not a resident of New Jersey, your monthly charge is free of state and local taxes. If state legislatures are to

achieve competitive neutrality in taxing phone service, states will need to include such communications services as VOIP in the tax reform mix.

Local Government Role

Political subdivisions of the state, local governments and other special districts, have been given the authority to levy taxes and fees on telecommunications services either by state laws or state constitutions. In many cases the local governments managed the rights of way in which the phone companies provided service to consumers. Most states gave the local governments the ability to place a fee or tax on these services as a way to recoup any cost for the use of the rights of way. Overtime, especially during the days of monopoly providers, these fees increased often having nothing to do with the actual cost of using the right of way and became more a tax on the gross receipts of the phone company. The phone company did not complain, it was passed on to the consumer. The same story with regard to discriminatory property tax.

As states move to review the taxation of telecommunications services, we have faced strong opposition from many of our local governments. For at least the last 100 years, local governments have been able to tax telephone service at rates higher than states allow them to tax general business services and local governments receive the money directly from the provider unlike general business taxes which are normally (except for Alabama, Arizona, Colorado and Louisiana) remitted to the state for distribution to local governments. While I can understand local officials concerns about possible revenue loss as a result of telecommunications tax reform, these hidden tax increases on unsuspecting consumers can no longer be justified or allowed.

In 2005, the Missouri General Assembly approved a major reform of local government taxation of telecommunications, which modernized terms and definitions so as to have a broad range of services included and reduced the overall rate of taxation. The legislation also brought to an end some multi-million dollar law suits that local governments had

filed against wireless providers for not collecting a tax that they, wireless providers, contended did not apply to them based upon the definition of phone service in state law. Even though the new legislation assured that local governments would maintain the level revenues received under the old system, many of the major cities in Missouri have challenged the constitutionality of the legislation and the legislatures authority to take such action. The Missouri Supreme Court heard oral arguments in April and a decision is expected shortly. NCSL filed an amicus brief on behalf of the Missouri General Assembly and supported its authority under the Missouri State Constitution to change the taxing authority of local subdivisions of the state as they will.

To be fair, I should point out that in Virginia, local governments were more willing to join negotiations and this certainly helped with the enactment of the Virginia legislation.

Last year, NCSL participated in process moderated by the National Governors Association which included our members, governors, local officials and representatives of the telecommunications industry. While there was agreement on some broad principles of reform, getting agreement on precise solutions to achieve those principles was elusive. I believe there was considerable consensus between state government representatives and industry representatives.

Provider and Consumer Role

As I stated earlier, tax reform of any kind usually does not occur in a vacuum. Telecommunications tax reform will likely be controversial in any state for some of the reasons stated above. State legislators need to hear not only from providers that there is a problem, how discriminatory taxation is a competitive barrier, but also from consumers, from the legislators' constituents. I have heard from numerous legislators that while they appreciate NCSL's advocacy on telecommunications tax reform, they have not heard much from their constituents about how much they are paying in taxes on telecommunications services.

NCSL has urged the providers and their associations to do a better job in educating the public about discriminatory telecommunications taxation. State legislators anticipate that should they consider tax reform legislation they will see publicity campaigns blaming them for wanting to reduce the taxes of wealthy telecommunications companies and thus forcing cutbacks in such areas as first-responders and teachers. The industry needs to support state legislative efforts with vigorous campaigns educating the consumer, the constituent, that these taxes are being paid by them not the companies and any reform will mean more money in the consumers' pockets.

I want to acknowledge the work of "MyWireless.org" which serves to educate consumers about the impact of state and local taxes on wireless services. This kind of education of consumers is vital. Like members of Congress, few state legislators will take the political risk of taking on powerful stakeholders in opposition to telecommunications tax reform if there is little or no support for such efforts from our constituents.

Federal Role in Telecommunications Tax Reform

While NCSL believes that telecommunications tax reform is primarily in the purview of elected state policymakers, we also acknowledge that with the end of the monopolistic era, telecommunications services and advanced technology networks do not respect state borders. What role should Congress and the Administration play in assisting states to achieve telecommunications tax reform?

Federal Role in State Telecommunications Tax Rate Reform

As I mentioned earlier, I am pleased to participate in this oversight hearing on the current status of telecommunications taxation. It is hearings such as this, that allows NCSL to raise the alarm with our members that we need to address this issue or face possible federal involvement, whether right or wrong, in an area that has traditionally been under the purview of state authority. We certainly would prefer to be able to work out

telecommunications tax reform legislation on a state by state basis with all the stakeholders rather than be forced to address these issues under a federal mandate that might not provide much flexibility to state legislatures to address issues that may be peculiar to a certain state or region.

While federal legislation has not been introduced or even appears in the title of this hearing, I think it is fair to assume that most of us have heard about proposals being considered that would require states to reform telecommunications taxation. Let me say for the record that NCSL could not support a blanket preemption of state taxing sovereignty with regard to telecommunications services. However, we are willing to work closely with the members and staff of this Subcommittee, our colleagues at the National Governors Association, and the representatives of the telecommunications providers on legislation that would encourage states to enact telecommunications tax reform legislation.

Should federal legislation be introduced to encourage states to address tax reform, NCSL would urge the members of this Subcommittee to include provisions that would allow states the ability to treat all providers of communications services in a competitively neutral manner. If we are to avoid having government pick winners or losers in the communications marketplace, Congress should remove any previous prohibitions on states from taxing certain telecommunications services as well as allowing states to include such services as VOIP. If VOIP services continue to be generally free of state and local taxation, many landline, wireless and cable providers will continue to have a competitive disadvantage.

Any federal legislation should also include a sufficient timeframe for states to address tax reform. States legislatures need at least two full sessions to consider tax reform legislation and I would respectfully remind this Subcommittee that there are still six state legislatures that only meet once every two years. As any tax reform likely will have revenue impact, it would be helpful both for states and local governments to have sufficient time to include this impact in their budget planning.

Finally, legislation that provided some kind of incentives, particularly geared to mitigating possible revenue loss also would be helpful. One possibility would be for Congress to consider and move the Sales Tax Fairness and Simplification Act.

Sales Tax Fairness and Simplification Act

The Sales Tax Fairness and Simplification Act would require states to apply the uniformity and simplifications of the Streamlined Sales and Use Tax Agreement to the collection and administration of all transactional taxes on telecommunications services, including rights of way fees and franchise fees, as a condition that a state would have to meet before the state could enjoy the authority to require remote sale tax collection. This provision in the federal legislation has the support of both NCSL and the National Governors Association.

The Sales Tax Fairness and Simplification Act of 2006, S. 2152, has been introduced by Senator Mike Enzi of Wyoming. I realize a companion bill has not been introduced in the House of Representatives as of yet, and we are hopeful that a bill will be introduced shortly. I want to acknowledge Congressman William Delahunt of Massachusetts, a member of this Subcommittee, for his previous sponsorship and support of this legislation and we look forward to having him as a sponsor in this Congress.

Congress has the opportunity to move a major part of the telecommunications tax reform agenda, collection and administration simplification, and in doing so, reducing the number of returns from the current 47,000 to a few hundred a year. This would substantially reduce provider compliance costs by the hundreds of millions of dollars each year and as a result reduce the cost of service to consumers. For this reason, most of the major telecommunications providers have endorsed the Sales Tax Fairness and Simplification Act.

One of the issues hindering telecommunications tax reform in the states, is the potential loss of revenue primarily at the local government level. A recent study has shown that revenue from telecommunications taxes is becoming the second largest revenue source for local governments after the property tax. If state legislatures try to reduce telecommunications taxes to the level of general business tax, we have two options, reduce rates on telecom providers by reducing revenues over the opposition of local government officials or reduce rates on telecom providers and raise rates on general business to offset the revenue loss. As you can guess, every industry that is not a telecommunications provider will rise up to oppose this alternative.

States do not have large surpluses of funds available to mitigate revenue loss from telecommunications tax reform, even over the short term. However, states could use some of the new revenues from presently uncollected sales taxes on remote transactions to help mitigate revenue loss from telecommunications tax reform. Congress in passing the Sales Tax Fairness and Simplification Act could give states the revenue they would need to mitigate revenue loss from reducing the discriminatory rates on telecommunications services.

The COPE Act

Congress has an excellent opportunity in H.R. 5252, the "Communications Opportunity, Promotion and Enhancement Act of 2006" or the COPE Act, to take an additional step toward telecommunications tax reform. While the legislation establishes a national franchise for video providers, many of whom are telecommunications providers, the legislation still requires the payment of franchise fees directly to the franchise authority. This means that video providers could still be sending returns to over 33,000 franchise authorities. Congress and the communications industry have the opportunity to take a step toward reform by reducing the returns to one per state, as the Sales Tax Fairness and Simplification Act would do. If Congress and the providers are serious about communications tax reform then collection and administration reform of franchise fees and taxes on video services must be included in any legislation to establish nationwide

video franchising. Congress can reduce the number of returns from 33,000 to 50, one per state.

Conclusion

The Mobile Telecommunications Sourcing Act of 2000 (MTSA) is a good example of Congress, state and local governments and industry working together on legislation that preserved state taxing authority while ensuring a uniform and simplified system for the collection of the taxes. We worked together in 2000 on a national tax regime for wireless services and I believe we can work together again.

A number of members of this Subcommittee have served in the state legislature, and I am sure if you think back to those golden days, you will recall how nervous we get whenever Congress begins to look at state laws, especially our ability to levy taxes. However, sometimes this can be a good thing. I believe this hearing and the threat of federal legislation will help NCSL to re-focus state efforts to address telecommunications tax reform for the 2007 legislative sessions. I would encourage this Subcommittee to continue these oversights hearings and should you introduce legislation, I would respectfully request that you work with NCSL and our counterparts in the National Governors Association.

Thank you for this opportunity.

Mr. CANNON. Thank you, Mr. Rauschenberger. It's always a pleasure to hear from you.

Mr. Kranz.

STATEMENT OF STEPHEN P.B. KRANZ, TAX COUNSEL, COUNCIL ON STATE TAXATION (COST)

Mr. KRANZ. Thank you, Mr. Chairman, for the invitation to participate in today's hearing.

As you said during the introductory remarks, my name is Steve Kranz. I am Tax Counsel with the Council on State Taxation, also known as COST. COST is a trade association that represents about 600 of the Nation's largest taxpayers, including companies from every industry segment and particularly those companies in the telecom and cable and technology arena which have been asked, and, in fact, forced by State and local laws to collect the taxes that we are discussing today.

COST's mission is to preserve and promote equitable and nondiscriminatory taxation, and as the 2004 State study and report on telecommunications taxation, which COST prepared, points out telecommunications and communications taxation is anything but. In fact, it is inequitable and discriminatory.

We have forced a square peg of a monopoly form of tax administration, left over from the days of telecom regulation, into the round hole of free market telecom service providers. The result is a system that's broken and in desperate need of repair.

COST has studied and commented on the tax structure facing telecommunications providers since 1999, has put on a number of those studies and can describe the landscape in really 2 words: Oppressively burdensome. We have a system of telecom taxation that violates every tenet of good tax policy, creates an untenable burden for telecom providers and more importantly for their customers. We ask telecom companies to collect tax from their customers under a set of rules that are so complicated no one can do the job correctly. We ask companies to collect tax from their customer at rates that make one think the product they're selling should be kept behind the counter of a convenience store and only sold to customers who are over the age of 18.

While a small number of States have made progress, as State Senator Rauschenberger has indicated, by improving their particular tax systems, the overall burden, as you see by looking at the 1999, the current study, has not significantly changed. In fact, the overall tax rate that is imposed by State and local governments continues to increase.

Telecom customers are taxed at a rate more than double the rate on goods sold by a normal or general business. Second, the accounting burden that's imposed by State and local tax authorities is astounding. Companies are required to file almost 50,000 tax returns a year if they do business nationwide.

Looking in further detail at the results of the telecom study. In 2004, as I said, the rate that was imposed on telecom services was double that was imposed on goods sold at a K-Mart. The average rate on telecom was over 14 percent, while the average rate on sales of goods was about 6 percent. This difference is something you can see in many of the States across this country. Eighteen

States have rates on telecommunications in excess of 15 percent. Nine of those States tax telecom services at rates exceeding 20 percent.

Turning to the accounting burden that is created by this system. I mentioned 50,000 tax returns a day. That's a big number. And if you break it down, it is over 190—I am sorry—50,000 and tax returns per year broken down is over 190 tax returns per business day, almost one every 2½ minutes. I don't know how much time it takes you to do your tax return or whether you do it, but it takes a long time to prepare tax returns and these companies are required to spend phenomenal resources filing those returns on a daily basis.

On a State-by-State level, when you look at the study, 18 States require companies to file more than a thousand tax returns per year. Of those, 6 States require more than 3,000 tax returns per year. Looking at your phone bill, as you said Mr. Chairman, you can see the complexity on its face. In Maryland, for example, there are 7 separate line items, different taxes that are imposed. In Washington State, there are 10 separate line items of tax imposed, and in New York, there are 12. Each of these line items requires a company to calculate, collect and remit tax information and dollars from consumers on a monthly basis.

In conclusion, while the phone bill gives you a snapshot, the 50-State study gives you a thorough picture of the complexity of the issue that exists out there. The difference in rates that is imposed on telecom companies and the administrative and accounting burden that results from the various impositions.

Mr. Chairman, and Members of the Subcommittee, thank you again for giving me the opportunity to testify. I hope that you provide—that you find the information and the COST study useful as you consider this difficult problem. And I'd be happy to respond to any questions that you'd have.

Mr. CANNON. Thank you, Mr. Kranz.

[The prepared statement of Mr. Kranz follows:]

PREPARED STATEMENT OF STEPHEN P. B. KRANZ

Testimony of Stephen P. B. Kranz

Before the

Subcommittee on Commercial and Administrative Law

Of the
Committee on Judiciary
United States House of Representatives

Hearing on

State and Local Telecommunications Taxation

Framing the Debate Over the Need for Federal Legislation
Addressing State and Local Taxation of Telecommunications Services

June 13, 2006

I am Stephen Kranz, Tax Counsel for the Council On State Taxation. The Council On State Taxation ("COST"), is a non-profit trade association formed in 1969 to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 of the largest corporations in the United States, including companies from every industry segment. COST's membership includes the traditional telecommunications service providers and many companies whose products are now bleeding into the telecommunications space. As such, COST's membership has been and continues to be concerned about the administrative and financial tax burden imposed on these services.

I am honored by the Chairman's invitation to testify today. I welcome the opportunity to share with the Subcommittee the analysis that COST has developed regarding the burden imposed by our current structure of state and local taxation of telecommunications services. While one might not need a fifty state study to understand the complexity and burden that exists – a glance at any phone bill will do the job – COST has issued four fifty-state studies of telecommunications taxation to more accurately evaluate the scope of the problem. The most recent study, the 2004 version, is the subject of my testimony today.

I. 2004 STATE STUDY AND REPORT ON TELECOMMUNICATIONS TAXATION

The 2004 50-State Study and Report on Telecommunications Taxation ("2004 State Study"), was prepared by the Telecommunications Tax Task Force[1] of the Council On State Taxation ("COST"). This study documents the current state of state and local taxation of telecommunications and analyzes changes that have occurred in the taxation of telecommunications since COST issued its last study in 2001.

Background

COST developed its original study in 1999 ("1999 State Study") in an effort to document the complex taxation of telecommunications providers and services under state and local transaction and property taxes, including certain special fees and taxes. The 1999 State Study highlighted the cumbersome and burdensome nature of the situation by comparing the relative tax and administrative burdens imposed on both general business and telecommunications providers and services under state and local transactional and property taxes.

[1] Individuals at the following COST member companies participated in the effort required to prepare the 2004 State Study: ALLTEL Corporation, AT&T Corporation, BellSouth Corporation, Cingular Wireless LLC, Level 3 Communications, Nextel Communications, Qwest Communications, SBC Communications, Sprint Corporation, Telephone and Data Systems, Inc., T-Mobile USA, Verizon Communications, Verizon Wireless.

Members of the COST Telecommunications Task Force compiled the 1999 State Study to provide the Advisory Commission on Electronic Commerce ("ACEC") with information documenting the onerous federal, state, and local level of taxation imposed on telecommunications. The 1999 State Study was presented to the ACEC at its second meeting in New York City on September 14, 1999.

The original study, and each version since, has generated substantial interest from the public and private sectors. The data documented in the study has been referenced in numerous articles and studies,[2] and is the focal point for much of the policy debate over telecommunications tax reform.

The Federal Discussion

The majority report of the ACEC, presented by Governor Gilmore to Congress in April of 2000, called for the elimination of multiple and discriminatory taxation of telecommunications services and property by 2004. It is now 2006 and the excessive tax burden on telecommunications continues virtually unabated.

The State Discussion

As a result of the ACEC recommendations in 2000, and in particular the recognition that federal legislation would be in order if discrimination were not eliminated by 2004, State and Local Government representatives and organizations offered to work with representatives of the industry toward a solution. They formed a group called the Telecommunications Tax Reform Initiative (TTRI), whose efforts were folded into the Streamlined Sales Tax Project (SSTP). Before and since the ACEC recommendations, the telecom industry has engaged in discussions and dialogue with state and local government representatives in various contexts. As recently as December of 2004, the industry renewed discussions with a broad group of state and local government organizations, including the National Governor's Association, the National Conference of State Legislatures, The Council of State Governments, the National Association of Counties, the National League of Cities, and the United States Conference of Mayors. As documented in COST's most recent 2004 Study, however, and although a few states have taken steps to reform parts of their telecommunications tax laws, there really has been no meaningful progress toward eliminating the multiple and discriminatory state and local taxes imposed on telecommunications.

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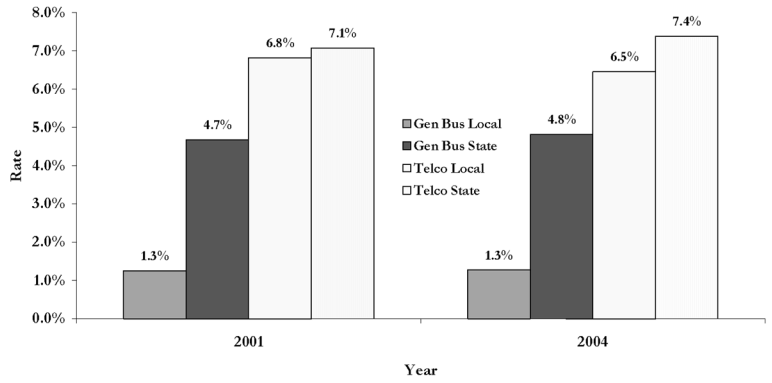
[2] *See* "Fixing the Phone-Tax Mess before it Gets Worse," Scott Palladino and Stacy Mazer, *Telecommunications Tax Policies: Implications for the Digital Age*, National Governors' Association, Washington, D.C., February 2000; *Business Week*, May 8, 2000; Joseph Cordes, Charlene Kalenkoski, and Harry Watson, *The Tangled Web of Taxing Talk: Telecommunications Taxes in the New Millenium*, The Progress & Freedom Foundation, September 2000; Jerry Hausman, "Efficiency Effects on the U.S. Economy from Wireless Taxation," *National Tax Journal*, Vol. 53 No.3 Part 2, p. 734 (September 2000); Scott Mackey, *Telecommunications and the Tangle of Taxes*, National Conference of State Legislatures, Denver, Colorado; Stephen Pociask, Telenomic Research "Taxing High-Speed Services: A Quantification of the Effects on the DSL Industry and Universal Service," New Millennium Research Council (April 26, 2004).

The 2004 State Study Findings

The 2004 State Study shows that the average effective rate of state and local transaction taxes for telecommunications services is **14.17%, compared to only 6.12%** for general businesses nationwide. Transaction taxes for telecommunications services include any state and local taxes applied to the cost of the service or the provision of the line to the consumer. Transaction taxes for general businesses are based on the traditional sales tax imposed on sales of tangible personal property and comparable transaction taxes. When accounting for federal transaction taxes the average effective rate for telecommunications services is 18.17% compared to 6.12% for general businesses nationwide.[3]

The following chart compares the change in the average effective rate from the 2001 study to the 2004 study. The comparison shows a slight decrease in the local rate from 6.8% to 6.5% and a slight increase in the state rate from 7.1% to 7.4%. Two factors account for the majority of the change. First, the 2004 study uses a higher average cost for service. As a result, the conversion of flat charges to an average effective rate produces a lower average effective tax rate even though the actual tax per line did not change. Second, the change reflects the simplification reforms enacted in some states shifting the tax burden from local level taxes to state level taxes.

Comparison of Tax Rates, 2001 - 2004: Local & State Rates for Gen Bus vs. Telco

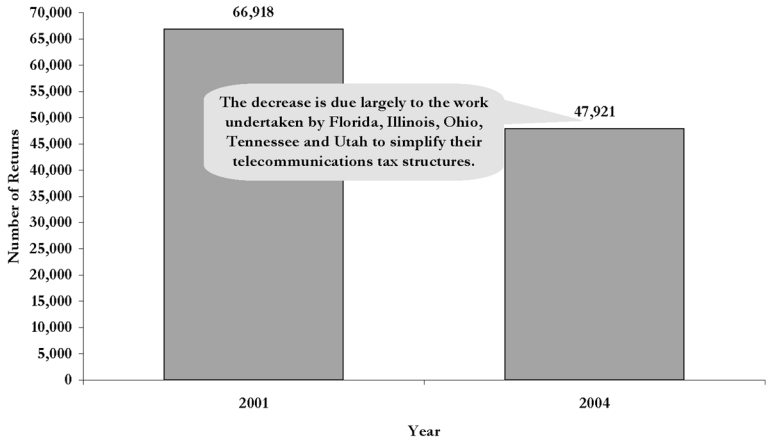


The total number of taxes imposed on telecommunications services is almost three times greater than for general businesses (123 versus 344). Compared to general businesses, telecommunications providers have 1,103 more transaction tax bases and 6,683 more

[3] The federal rate of 4% reflects the federal excise tax on telecommunications plus an additional 1% to reflect the impact of the universal fund surcharges.

taxing jurisdictions with which to contend. Telecommunication providers must file 47,921 returns compared to 7,501 returns for general businesses. These inequities stem from outmoded statutes that originated during the era when telecommunications companies were closely regulated monopolies. These outmoded and discriminatory tax schemes no longer work in today's competitive and highly dynamic environment.

Total Number of Returns Required Nationwide



COST Telecommunications Task Force Conclusions

Deregulation of the telecommunications industry, convergence of technologies and providers and increased competition continue to have an impact on the competitive marketplace. The state and local tax laws continue to impose high levels of industry-specific taxation on telecommunications services. While some states have begun the process of reforming the state and local tax structure, much more is needed to reduce the high level of telecommunications taxation and administrative burden imposed at most levels of government. As business and residential consumers become increasingly reliant on communications services provided over the nation's telecommunications networks, the burdens and complexities imposed by the existing telecommunications tax system will continue to have a substantial impact on the cost of such services to consumers. The burdens and complexities of the existing telecommunications tax system are evidenced by the data contained in the 2004 State Study.

Currently, the language in many tax statutes results in the imposition of different taxes on similar telecommunications services depending on the historic classification of the business providing the service. New technologies are having an impact on the types of services being provided to customers, the method of delivery and the means of

accounting for such services.

The tax system has not kept pace with changes in telecommunications technology, generally rendering the current system inequitable and unworkable. The telecommunications tax system should be overhauled to eliminate the discriminatory administrative and tax burden facing telecommunications providers and services.

* * *

My purpose here is only to describe the issue for the benefit of the Subcommittee and not to address the difficult political issues that are raised by attempting to reconcile the demands of a streamlined telecommunications tax structure and the concerns of state and local political subdivisions.

Once again, I thank the Chairman for inviting me to testify before this Subcommittee, and I will be happy to respond to any questions or to provide any other assistance that the Chairman or other Members of the Subcommittee may find helpful.

Mr. CANNON. We want to acknowledge the presence of Mr. Coble from North Carolina and the gentlelady from Florida, Ms. Wasserman Shultz, who have joined us for the hearing.

And Mr. Quam, you are recognized for 5 minutes.

STATEMENT OF DAVID QUAM, DIRECTOR, OFFICE OF STATE AND FEDERAL RELATIONS, NATIONAL GOVERNORS ASSOCIATION, WASHINGTON, DC

Mr. QUAM. Thank you, Chairman Cannon, Ranking Member Watt, Members of the Committee. My name is David Quam. I am the Director of Federal Relations for the National Governors' Association and greatly appreciate the opportunity to testify here today.

Telecommunications tax reform has been a major issue for the governors over the past year. As I am sure we'll discuss, the NGA was essential in trying to pull together industry and State and local officials together last year to have a discussion about what could be done regarding the status of State and local taxes on telecommunications, and really, it's a communications issue. Not just telecommunications, but all the different communications mediums which are now competing against one another.

I'll talk a little bit about those reforms, but first, there are four main points that I'd like to get across to the Committee today. First and foremost is that issues and responsibility for State and local taxations should be left to State and local officials. Ultimately, this is about State and local revenues, and State and local taxes and governors and State legislatures are very concerned with both those revenues and control of those tax systems.

Second, an acknowledgement that changes do need to be made. Communications technology has evolved far beyond the existing State tax systems and a failure to act on behalf of States will only create increasing disparities among competitors and threaten long term revenues for State and local governments.

Third, States are working to reform their taxes. Perhaps not at the speed that some in industry would like, but States are working very actively to try to modernize their tax systems, reduce administrative burden, and, in some cases, reduce rates.

Finally, that Congress can best support State tax modernization by ultimately avoiding Federal action that will restrict the ability of States to craft meaningful reforms. Again, this gets back to the principle of federalism because we're talking about State and local taxes. Reforms and solutions really need to come from State and local governments.

The discussions that NGA hosted were quite comprehensive, and, I should say, quite difficult.

NGA and members of the big seven organizations, including NCSL, the National League of Cities, the Conference of Mayors, the Association of Counties, and others, joined together with representatives from the telecommunications industry, from the Internet industry, and cable and satellite television. All of the major players who are currently involved in communications—in the communications industry to try to discuss what could be done. First, what are the problems associated with State and local taxation. Second what are the principles for reforms for the different groups

and, third, could consensus be developed to create some sort of solution that could be enacted by State and local governments.

A couple of key points became clear during those discussions. First, of course, that the current system of taxation is complex and does not completely reflect today's market for communications services. Several State taxation systems continue to tax communications based on the technology used to provide them rather than the service. It is these silos that often create disparities between new competitors in the market place.

Second, industry regards certain, if not most, State and local tax practices and requirements as barriers to their ability to compete in an ever-increasing competitive market place. This is best summed up by one of the participants who said, "in my estimation the real problem here is that there are 49 too many States." I think that's summed up where industry was coming from with regard to State and local taxation.

Another industry observation from a non-telecom: "Nobody wants to be a telecommunication company." If you look at the tax burden and some of the regulatory burdens, anybody out side of that rubric would like to remain out there.

Third, every one wants to preserve their own competitive advantage. If a statute allows you a business model that gives you a competitive advantage over another member, you are going to want to preserve the status quo. These are all obstacles for reform. From the State standpoint, local and State officials are committed to competition and encouraging innovation. There is no governor that wouldn't want more broadband access in their State. However, State sovereignty also has to mean something, and at its core, that is the ability to structure State and local revenue systems, regulate businesses and protect and promote the public interest.

And finally, for State and local governments, revenues do matter. Any reform that simply shifts cost to States away from States is going the create more problems than it ultimately solves. And so anything that is just a simple tax cut without more comprehensive reforms, creates difficulties.

As I said before, States are working to reform their systems. The COST study, which we've heard about, cites simplification reform in Florida, Illinois, Ohio, Tennessee, and Utah as having decreased the number of tax returns that a telecommunications provider must file by over 18,000.

More recent reforms in Missouri and Virginia have gone even further. Virginia is a particularly interesting example—having just passed, it will take effect this year. The back story on Virginia's new tax, one that combined several different communications industries to broaden the base and lower the rate, is that it involved all levels of government negotiations between the governors office, State and local government, and different industry groups.

Finally, States have also supported wide ranging telecommunications tax reforms as part of the streamlined sales and use tax agreement. This is the State-based voluntary agreement. Under that agreement, States are required to adopt uniformed definitions in administrative rules in return for collecting taxes from revoked vendors that volunteered to participate in the agreement. The governing board recently adopted new definitions that will require

States participating to adopt those definitions into their State laws for purposes of sales tax. So there is considerable reform going on at the State level.

When State and local government went into the discussions that we held with industry. And I should say that ultimately they did not prove fruitful because of some of the conflicts we had between revenue neutrality and competitive neutrality.

There were several different principles that were important to State and local government. First and foremost, reform should be technology neutral focusing on the service rather than the technology used to provide the service. Second, reform should be revenue neutral, hence one of the problems during our discussions. That's debated over 20 billion annually telecommunications taxes not only support general revenues, but are often allocated at the local level to pay for specific purposes ranging from education to improving public safety systems.

The potential to significantly reduce State and local tax revenues is one of the primary difficulties with simply subscribing to a request that telecommunications industry be treated just like a general business. As the COST study asserts, and assuming the numbers are correct, and Steve, I'll give you the benefit of the doubt—the telecom tax rate stands at 14.17 percent compared to only 6.12 percent for general business. Mandating a reduction on telecommunications rates to those of general business with the effort required of 51 percent increase.

Third, the Federal Government should not pre-empt State and local taxing authority. Fourth, the role of State and local government in serving public interest obligations must be maintained in any sort of reforms. And fifth, reform can not happen over night.

The complexity of State and local tax systems does not lend itself to an immediate or one-size-fits-all solution. Reform should incorporate the interest of all affected parties and allow for sufficient transition time to fully implement comprehensive reform.

I'll be happy to take any questions from the Committee.

[The prepared statement of Mr. Quam follows:]

PREPARED STATEMENT OF DAVID QUAM

Chairman Cannon, Ranking Member Watt, distinguished members of the committee, my name is David Quam and I am the Director of Federal Relations for the National Governors Association (NGA). I appreciate the opportunity to appear before you today on behalf of NGA to discuss issues related to the taxation of communications services at the state and local level.

OVERVIEW

Last year NGA embarked on an ambitious effort to develop consensus between representatives of the communications industry and state and local officials regarding the future of state and local taxation of communications services. For over eight months participants representing the wireline and wireless telecommunications sectors, cable and satellite television and state and local governments met to examine the issues raised by the current systems of taxation, formulate principles for reform, and if possible, craft a consensus for promoting changes that could benefit industry, government and consumers.

Through those discussions several points became clear:

- The current system of taxation is complex and does not completely reflect today's market for communications services.
- Industry views certain state and local tax practices and requirements as barriers to their ability to compete in an increasingly competitive marketplace.

- State and local government officials are committed to encouraging innovation and deployment of communications services while also protecting the public interest and providing for the needs of their citizens.

The last two points proved the most difficult to reconcile. From the industry perspective, the days of monopoly service have given way to a competitive and evolving marketplace. Traditional state and local tax laws, which are generally based on the technology used to deliver communications services, distort the marketplace by disproportionately favoring one industry over another. The solution proposed by the telecommunication industry was to end specific telecommunications taxes and treat telecommunications service providers like a "general business."

In contrast, state and local officials recognized the need to modernize existing tax laws, but stressed that reform also must reflect government's responsibility to protect the public interest and remain cognizant of the need for state and local governments to balance their budgets and structure their revenue systems.

In the end, these competing interests prevented consensus, but they also made it clear that the complexity of state and local tax systems requires that long-term comprehensive solutions evolve from states—not the federal government. The ability of states to structure their revenue systems is a core element of sovereignty that must be respected by the federal government. Congress therefore can best support state tax modernization by avoiding federal action that will restrict the ability of states to craft meaningful reforms.

BACKGROUND

In 2000, NGA's Center for Best Practices issued a paper calling for Governors and state legislators to "reexamine the state and local tax treatment of the telecommunications industry." ("Telecommunications Tax Policies: Implication for the Digital Age," NGA Center for Best Practices, 2000). The report concluded that existing state and local tax systems were ill-suited for the modern telecommunications marketplace, stating:

> "[S]tate and local telecommunications tax systems are not competitively neutral. In many cases, the current tax structure favors some segments of the industry over others. In other instances, the tax burden on the telecommunications industry is greater than that of other industries. In either case, telecommunications companies are not competing on a level playing field. The current tax system forces these companies to compete not only on the basis of economic factors, but also on the basis of the tax differential among them."

The report went on to recommend that state policymakers review their state telecommunications taxes with goals of increasing tax efficiency, competitive neutrality, tax equity and administrative simplicity. Importantly, however, the report recognized that many of its reforms are not revenue neutral and that the fiscal impacts of any changes on state and local government "need to be a major focus of any proposals."

STATE TELECOMMUNICATIONS TAX REFORMS

Since 2000, several states have taken up the mantel of telecommunications tax reform. As noted in the Council on State Taxation's 2004 State Study and Report on Telecommunications Taxation (COST Study), simplification reforms in Florida, Illinois, Ohio, Tennessee and Utah decreased the number of tax returns that a telecommunications provider must file by 18,610. More recent reforms in Missouri and Virginia have gone even further. The Missouri law, which will take effect Aug. 28, 2006, expands the municipal tax base by making it clear that providers of cell phone and other wireless telecommunications are subject to the same tax as wired telecommunications. In return, the state (rather than municipalities) will collect the tax and apply a new 5 percent ceiling to all municipalities by 2010.

Virginia's new communications tax law is even more comprehensive, streamlining existing state and local taxes into a statewide, flat-rate structure and eliminating local cable-franchising fees. Beginning January 1, 2007, the commonwealth will collect the tax and disburse rebates to municipalities on a share basis reportedly equal to what they now gather from the existing tax structure. In addition, a statewide rights-of-way use fee will be applied to all cable-TV service lines in the same way it is currently applied on all local exchange telephone lines. Supporters of the law maintain the new measure will raise approximately the same amount of revenue that municipal authorities now receive from local taxes and franchise fees. The standardized rate is distributed evenly among communication services resulting in reductions in the monthly phone bill for most residential customers.

States have also supported wide-ranging telecommunications tax reforms as part of the Streamlined Sales and Use Tax Agreement. Under the Agreement, states are required to adopt uniform definitions and administrative rules in return for collecting sales taxes from remote vendors that volunteer to participate in the Agreement. The Governing Board (the governing body for the Agreement) recently adopted uniform definitions for telecommunications services that will require changes to the tax laws of the Agreement's member states. The benefits of the Streamlined Agreement—central collection; uniform definitions, customer remedy procedures and sourcing rules; and notification of and limitations on local rate and boundary changes—represent critical reforms that will significantly reduce complexities and ease providers' administrative requirements.

OPENING A DIALOGUE

While states worked individually to modernize their tax systems, it was the debate over how to best extend the federal Internet access tax moratorium that underscored the need for states and local governments to work with communications providers to address state tax issues.

A key part of the extension debate was how to level the perceived tax disparities between telecommunication and cable broadband offerings and address the rise of new Internet-based services such as Voice-over-Internet-Protocol. Those industry sectors not subject to the moratorium argued for their inclusion to promote competitive neutrality. Those subject to the moratorium argued to preserve their exempt status; and those outside the moratorium fought to prevent the transfer of any additional tax responsibility to their industry. The debate illustrated the difficulties states face in modernizing their tax systems to make them competitively neutral: industry sectors that stand to gain from reform support state efforts; industries with an existing competitive advantage due to state or federal restrictions fight to maintain the status quo.

Following passage of the extension, NGA called for an open a dialogue between state and local elected officials and industry representatives to examine current taxation practices, compare principles and priorities for reform, and determine whether any consensus exists for modernizing state and local communications taxes.

State and local government associations worked together to develop key principles to help guide discussions with industry. First, reforms should be technology neutral, focusing on the service provided rather than the technology used to provide the service. Such a change would decrease discriminatory tax treatment between competing service providers and allow for greater certainty for new entrants.

Second, reforms should be revenue neutral for state and local governments. Estimated at over $20 billion annually, telecommunications taxes not only support general revenues, but are often allocated at the local level to pay for specific purposes ranging from education to improving public safety systems. The potential to significantly reduce state and local revenues is one of the primary difficulties with simply subscribing to the demand of the telecommunications industry to be taxed like "general business." The COST study asserts that the average effective rate of state and local transaction taxes for telecommunications services is 14.17%, compared to only 6.12% for general business. Mandating a reduction of telecommunications rates to those of general businesses would therefore require a 51% decrease in state and local tax rates. Actual revenue losses would likely exceed the $6.987 billion difference estimated in a November 2001 study prepared by Ernst & Young LLP for the Telecommunications State and Local Tax Coalition.

Third, the federal government should not preempt state and local taxing authority. Governments at the federal, state and local level have long recognized that communications services play a unique and critical role in modern society that may require different regulatory and tax treatment from those imposed on general businesses. Furthermore, state and local jurisdictions are generally required to balance their budgets. A federally mandated reduction of more than $7 billion in telecommunications tax revenue would require spending cuts or revenue increases to cover the loss. The ability of states to structure their revenue systems to fund government services is a core element of state sovereignty that should not be undermined by federal authorities.

Fourth, the role of state and local government in preserving public interest obligations should be maintained. The responsibility of managing public-rights-of-way, funding public safety infrastructure, providing consumer protection and promoting universal service are critical state and local functions. Reforms to state and local tax systems should not undermine government's ability to carry out its responsibilities to protect the public interest.

Fifth, reform cannot happen overnight. The complexity of state and local tax systems does not lend itself to an immediate or one-size-fits-all solution. Reform should incorporate the interests of all affected parties and allow for sufficient transition time to fully implement comprehensive reforms.

CONCLUSION

A modern communications infrastructure that provides high-quality, reliable, and affordable communications services is essential to the economic competitiveness of states and the nation. Recent technological advancements in communications services are fundamentally changing the manner and means by which consumers communicate with one another. These changes have led to the development of new services, greater competition and increased consumer choice. Technological advancements also pose challenges for states, which generally tax communications services based on the technology used to provide the service rather than the service itself. Left unchanged, these laws will create inequities between competing service providers and diminish state communication tax bases as new technologies evolve beyond existing laws.

Although NGA's efforts to develop consensus recommendations for reform were not immediately successful, Governors continue to support state efforts to modernize their tax systems in a manner that promotes innovation and competition, encourages investment, preserves state authority, provides necessary resources and advance the public interest.

Mr. CANNON. Thank you. We've got a bill for a vote. We have a couple of votes, but I think we have time, Mr. Mackey, for your testimony and we will come back and do questioning afterward.

STATEMENT OF SCOTT R. MACKEY, ECONOMIST AND PARTNER, KIMBELL SHERMAN ELLIS LLP, MONTPELIER, VT

Mr. MACKEY. Thank you, Mr. Chairman, Representative Watt, and Members of the Committee. As you said in your introduction, Mr. Chairman, I have looked at this issue from both sides now. I've worked with the wireless industry for the last 5 years, specifically trying to address the discriminatory and excessive State and local tax burdens, and also, when I was at NCSL I was working on it too. I think—seeing it from both sides—it is clear that the problem, as defined on both sides, is the same. Everyone acknowledges there is a problem, and of course, the stumbling block is how to solve it.

I am going to focus on something that you, Mr. Chairman, and Representative Watt mentioned in your opening statements, which is the economic impact of some of these taxes. I'm going to talk specifically in my short time about consumers and about the overall economy, because these taxes and the tax systems that we've allowed to sort of become institutionalized really have impacts that—broadly on the national economy and on consumers that don't get a lot of attention but perhaps really should.

On the first point concerning consumers. Everybody in the State and local world knows that consumption taxes are regressive, and I think what you see with telecommunication taxes is you have a layering effect of one regressive tax on top of another regressive tax on top of another, you know, where you have multiple taxes at the State and local level all being layered on the consumer. And as a result, you have sort of a very regressive tax system on our people on fixed incomes and our low income households. When you have average effective rates of 15 percent—as has been talked about in the COST study—obviously a tax on telecommunications and other communications services is going to have a much bigger impact on somebody with a lower income than a higher income.

A troubling trend recently is some jurisdictions actually imposing flat rate taxes. For instance, in the City of Baltimore, where the city imposed a $3.50 per line tax on wireless and wireline phone lines. Well, obviously, at $3.50 as a percentage of a $25 cheapest plan you can get is a lot higher than $3.50 on a $100 plan. And the impact can be even magnified in households where you have families—at least in the wireless side, for instance, you have, you know, buy your first phone and sign up for a second or third line for only $10 more a month. Well, the marginal rate on some of those second and third lines is 40 percent if you are only paying $10 more and you are adding $3.50 in tax plus 5 percent tax.

So we really have a situation where the regressive nature of these consumption taxes is really, really magnified in the area of communication services tax.

Now consumers are burdened, but consumers are also wage earners. They're also out there trying to earn a living. And the other point I wanted to make is the economic impact of these communication services taxes really affect the whole economy because, as others speakers have alluded to, we've moved from a monopoly structure where there wasn't choice, there wasn't competition for consumers. Taxes were buried in the bills and essentially taxes didn't matter. You were buying plain vanilla communication services and the tax that you pay really wasn't going to affect what you were buying. Now we are in a situation where consumers have choices of providers, choices of technology. And they're really—more and more of their dollars are being spent not so much on plain vanilla communication services, but on other things: downloads and things like that.

So what you are seeing is consumers are a lot more price sensitive today than they were in the monopoly era. And when you impose taxes of 15 percent and as high as 20 percent and more in some States, what you have is a real impact on consumers' purchasing choices. One study that looked only at wireless, but a lot of it, I think, is true for other communication services as well, found that every 1 percent increase in the price is going to reduce consumer demand by between 1.1 and 1.3 percent. So you can imagine a system where you have tax burdens that are 9 percent—7 to 9 percent higher than what you buy at the store. That's going to translate into a 10 to 12 percent reduction—in consumer expenditures on communications.

So what does that mean to the economy? Well, obviously the communications companies—wireless, wireline, cable—are investing huge amounts of money to push advanced communications network broadband out to more consumers so they can compete with each other and get into everybody's business. And obviously this benefits consumers because the more competition there is, you are going be able to get a better deal. And what we are finding is that these taxes that have an impact on how much revenue, you know, cash flow from operations—that these companies have available to invest back in their networks. And these are not insignificant amounts of money. In the wireless side, it's 20 billion a year. I am sure it is higher, even higher in cable and wireline telecom as well. And this is how these advance communications networks are going

to be built: by the private sector investing money to get these services out there.

Now, the reason this is important is because study after study has showed that there are huge productivity benefits to the U.S. economy when we can get these networks out there and get businesses and consumers and everybody using them to be more productive. In fact, a study that was recently done by Ovum and Indepen found that 80 percent of the productivity gains in the year 2004 were estimated to come from information technology and communications.

So obviously, the more money that companies have to invest in networks, there is going to be more productivity benefits that are going to accrue to everybody. And when we talk about the revenue concern that the local governments have, those are real concerns. But there is also the possibility that we can create a bigger pie and have people spend more on services if we didn't have some of these discriminatory taxes that are going to result in more tax revenues coming in for everybody, higher incomes, and all of the positive things that we saw in the '90's with the Internet and the growth of e-commerce.

So these taxes do matter to the economy. And you know, to the extent that these tax structures are retarding investment in advanced communication services, that's a problem.

And I'll just sum up with a simple maxim that if you want more of something, subsidize it, if you want less of something, tax it. And unfortunately, we are taxing our way to slower broadband deployment, less investment by the private sector in advanced communication services. And we're doing that at a time when State and local governments and their economic development people are very serious about wanting to get this out there. On the one hand, we have these tax structures that are retarding investments and in some areas we actually have subsidization going on to try to get more of it.

These taxes really do have an impact directly on the consumer as a purchaser, but also the overall economy and affect it that way. So it is a very important issue, and it is great that this Committee is looking at it because of these national implications of what we are doing, and I know you have a vote. I look forward to the question period, and I thank you.

[The prepared statement of Mr. Mackey follows:]

PREPARED STATEMENT OF SCOTT R. MACKEY

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Testimony of
Scott R. Mackey
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Oversight Hearing on State Taxation of Interstate Telecommunications Services

House Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

June 13, 2006

Chairman Cannon, Representative Watt, and members of the subcommittee, thank you for this opportunity to testify on an issue of real importance to millions of consumers, small and large businesses, communications service providers, and the US economy.

My name is Scott Mackey and I am an economist and partner at Kimbell Sherman Ellis LLP. Over the past six years, I have worked as a consultant to major wireless telecommunications providers to reduce or eliminate excessive and discriminatory taxes on communications services at the state and local level. It has been a frustrating experience to say the least, because while state and local government officials recognize that this is a major problem, with one notable exception, there has been no progress in reducing the tax burden on communications users. In fact, excessive and discriminatory taxation of communications consumers has gotten worse.

The underlying principle that the communications industry seeks on behalf of its customers is tax fairness. Quite simply, the industry believes that consumers of communications services should be taxed like consumers of other goods and taxable services. The industry is not asking that its customers be exempt from paying taxes, just that customers not be targeted with excessive and discriminatory taxes. Unfortunately, throughout the country, most consumers of communication services pay some type of excessive and discriminatory tax. Many consumers do not know that they are paying these excessive taxes. However, when told that such taxes greatly exceed those imposed on other goods and services, consumers believe these taxes are unfair.

In my testimony today I seek to identify four areas of concern:

1) Establish that the problem of excessive and discriminatory taxation of communications consumers is a real problem – one that is getting worse, not better

and needs to be addressed at a national level;

2) Discuss how the communications industry has worked with state and local elected officials for at least the last seven years to address this problem with very little to show for these efforts;

3) Explain how discriminatory and excessive state and local taxes on communications services hurt consumers (especially young and old consumers of modest means) and reduce capital investment in the communications infrastructure at a time when economic development experts believe such investment is critical to the US economy;

4) Discuss the benefits to consumers and the entire US economy of a federal policy that prevents states and local governments from burdening communications consumers with excessive and discriminatory taxes.

The Problem of Excessive and Discriminatory Taxation of Communications Services

The first comprehensive attempt to catalog the tax burden on communication services providers and their customers was published in September 1999 by the Committee on State Taxation (COST). This landmark study found that consumers of telecommunications services paid effective state/local tax rates that were more than twice those imposed on taxable goods sold by general business (13.74% vs. 6%). Including federal taxes, the tax burden was nearly three times higher than general business. In addition, due to the sheer number of different state and local taxes imposed in many jurisdictions, the typical communications service provider was required to file seven to eight times as many tax returns compared to those filed by typical businesses (63,879 vs. 8,951 annually).

I published a follow-up study in *State Tax Notes* in July 2004 using the COST study methodology to examine in more detail the tax burden on wireless customers. Its findings were consistent with the COST study – that wireless customers faced tax burdens that were, on average, two to three times higher than general business. The full study is attached as Appendix A.

Table 1 ranks the tax burdens on wireless consumers by state as of July 1, 2005:

Federal, State & Local Taxes, Fees, and Charges on Wireless

1-Jul-05

State	State-Local Effective Tax Rate	Rank	Gen'l Bus. Effective Tax Rate	State-Local vs. Gen'l Business	Federal Effective Tax Rate	Fed/State/Local Effective Tax Rate	Fed/State/Local vs. General Business
Nebraska	18.72%	1	7.00%	11.72%	5.91%	24.63%	17.63%
Washington	17.48%	2	8.60%	8.88%	5.91%	23.39%	14.79%
New York	16.09%	3	8.38%	7.71%	5.91%	22.00%	13.62%
Florida	15.08%	4	7.00%	8.08%	5.91%	21.99%	14.99%
Texas	15.13%	5	8.25%	6.88%	5.91%	21.04%	12.75%
Rhode Island	14.49%	6	7.00%	7.49%	5.91%	20.40%	13.40%
California	14.10%	7	8.00%	6.10%	5.91%	20.01%	12.01%
Pennsylvania	13.47%	8	6.50%	6.97%	5.91%	19.38%	12.88%
Utah	13.00%	9	6.43%	6.57%	5.91%	18.91%	12.48%
Illinois	12.79%	10	8.00%	4.72%	5.91%	18.63%	10.63%
South Dakota	11.79%	11	6.00%	5.79%	5.91%	17.70%	11.70%
District of Columbia	11.56%	12	5.75%	5.75%	5.91%	17.41%	11.66%
Tennessee	11.47%	13	8.25%	3.22%	5.91%	17.38%	9.13%
Kansas	11.48%	14	7.38%	4.08%	5.91%	17.37%	9.99%
Arkansas	11.07%	15	8.38%	2.69%	5.91%	16.98%	8.60%
North Dakota	10.85%	16	6.25%	4.57%	5.91%	16.73%	10.48%
Missouri	10.45%	17	6.88%	3.57%	5.91%	16.38%	9.46%
Maryland	10.43%	18	5.00%	5.43%	5.91%	16.34%	11.34%
Arizona	10.03%	19	7.85%	2.18%	5.91%	15.94%	8.09%
Oklahoma	9.83%	20	8.45%	1.38%	5.91%	15.74%	7.29%
Colorado	9.59%	21	6.25%	3.34%	5.91%	15.50%	9.25%
Kentucky	9.04%	22	6.00%	3.04%	5.91%	14.95%	8.95%
Mississippi	8.97%	23	7.00%	1.97%	5.91%	14.88%	7.88%
Indiana	8.83%	24	6.00%	2.83%	5.91%	14.74%	8.74%
Minnesota	8.54%	25	7.00%	1.54%	5.91%	14.45%	7.45%
South Carolina	8.43%	26	6.25%	2.18%	5.91%	14.34%	8.09%
New Mexico	8.37%	27	7.03%	1.34%	5.91%	14.28%	7.25%
New Hampshire	7.83%	28	0.00%	7.83%	5.91%	13.74%	13.74%
Georgia	7.80%	29	7.00%	0.80%	5.91%	13.71%	6.71%
New Jersey	7.78%	30	6.00%	1.78%	5.91%	13.69%	7.69%
Hawaii	7.69%	31	4.00%	3.69%	5.91%	13.60%	9.60%
North Carolina	7.58%	32	6.50%	1.08%	5.91%	13.49%	6.99%
Virginia	7.41%	33	5.00%	2.41%	5.91%	13.32%	8.32%
Alabama	7.38%	34	8.00%	-0.62%	5.91%	13.29%	5.29%
Maine	7.29%	35	5.00%	2.29%	5.91%	13.20%	8.20%
Vermont	7.27%	36	6.00%	1.27%	5.91%	13.18%	7.18%
Wyoming	7.10%	37	5.50%	1.60%	5.91%	13.01%	7.51%
Michigan	7.03%	38	6.00%	1.03%	5.91%	12.94%	6.94%
West Virginia	6.92%	39	6.00%	0.92%	5.91%	12.83%	6.83%
Ohio	6.88%	40	6.88%	0.00%	5.91%	12.79%	5.91%
Iowa	6.84%	41	5.50%	1.34%	5.91%	12.75%	7.25%
Connecticut	6.39%	42	5.50%	0.39%	5.91%	12.30%	6.30%
Massachusetts	5.59%	43	5.00%	0.59%	5.91%	11.50%	6.50%
Wisconsin	5.53%	44	5.53%	0.00%	5.91%	11.46%	5.91%
Delaware	5.45%	45	0.00%	5.43%	5.91%	11.34%	11.34%
Montana	4.95%	46	0.00%	4.95%	5.91%	10.84%	10.84%
Louisiana	4.33%	47	9.00%	-4.67%	5.91%	10.24%	1.24%
Alaska	3.73%	48	2.50%	1.23%	5.91%	9.64%	7.14%
Oregon	1.68%	49	0.00%	1.68%	5.91%	7.59%	7.59%
Idaho	1.62%	50	5.00%	-3.38%	5.91%	7.53%	2.53%
Nevada	1.09%	51	7.13%	-6.04%	5.91%	7.00%	-0.13%
					5.91%		
US AVG	**9.12%**		**6.05%**	**3.07%**	**5.91%**	**15.03%**	**8.98%**
(simple avg.)							

Assumptions: Flat rate taxes and fees -- use average monthly bill of $50.64 to calculate effective tax rates.
Federal: 3% FET and 2.92% USF (10.2% contribution factor for 2005 Q3 x 28.6% hold harmless)

An update to the COST study found that the average state/local tax burden had grown from 13.74% in 2000 to 14.17% in 2004, as compared to an increase from 6.0% to 6.12% for general business. For wireless, the average burden increased from 8.38% in 2003 to 9.12% in 2005. Furthermore, when the tax burden is weighted by state population, the wireless effective rate increased from 10.20 % on January 2003 to 10.94% in July 2005. At the same time, the tax rate on general businesses increased only slightly, from 6.87% to 6.94%. Clearly, the problem of discriminatory taxes on communications services is getting worse.

During this period, several states had large increases in the tax burdens imposed on communications customers. Pennsylvania added a 5% gross receipts tax on wireless and interstate long distance service beginning in 2004. This tax was added despite the fact that telecommunications service is already subject to the 6% state sales tax. South Dakota added a 4% gross receipts tax on wireless service, again subjecting customers to a "double tax" of both the sales taxes and gross receipts tax. Kentucky imposed a new 1.3% gross receipts tax on communications services, although the bill eliminated other discriminatory taxes. Just this spring, Texas adopted a new gross receipts tax of at a rate of 1% on telecommunications providers but only ½% on general business.

Baltimore City imposed a new $3.50 per month "line charge" on phone bills in 2004, while Montgomery County Maryland added a $2.00 monthly charge. The City Council in Corvallis, Oregon has just voted to impose a new 5% discriminatory tax on telecommunications users, notwithstanding that there is no comparable tax on general business. In Missouri, local governments are trying through court action to impose local business license taxes at rates as high as 10%, even though license taxes on general businesses are typically well below 1%.

These increases in the tax burden on communications service customers have been adopted despite the fact that state and local governments have enjoyed very solid revenue performance during the last three years. For example, the Center for the Study of the States reported that quarterly state tax collections have grown, on average, by 9.7 percent since January 1, 2004. At the local level, rapid and sustained growth in property values has pumped property tax revenues into local government coffers across the country.

Efforts to Address This Problem with State and Local Governments

As Congress studies this problem and considers what action should be taken to protect consumers and the economy, it is fair to ask whether communications providers have attempted to address remedies to the excessive consumer taxes directly with state and local governments. The answer is unequivocally yes. In fact, for almost a decade, communications service providers have engaged in a dialogue with representatives of state and local government organizations – and state legislatures – actively trying to address the problem.

The Advisory Commission on Electronic Commerce was formed by Congress in 1998 as part of the original Internet Tax Freedom Act to examine issues surrounding the taxation on Internet access, electronic commerce, and communications. The Commission held hearings on these issues throughout 1998 and 1999. In 1999, the communications industry testified before

the commission on the impact of excessive and discriminatory taxation of communication services, the communications infrastructure needed to build out networks, and the daunting compliance burden placed upon providers asking the commission to prod states toward substantial reform in these areas.

One commission member, California State Board of Equalization member Dean Andal, suggested that the Commission recommend that Congress pass legislation outlawing discriminatory taxation of communications services by state and local governments. However, at that time industry did not support the Andal approach because state and local organizations had expressed support for working jointly with the industry on reforming excessive taxes on communication consumers. At that time, the industry believed that working together with state and local governments would achieve the needed reform.

As a result of the Commission members' failure to reach a 2/3 majority consensus, the Commission ultimately did not forward any recommendations to Congress. However, the communications industry used the Commission's work as a springboard to reach out to key government organizations such as the National Conference of State Legislatures (NCSL) and the National Governors' Association (NGA) – as well as the local organizations – to promote reduction of taxes on its consumers. As a result of the ongoing dialogue, both the NGA and the NCSL issued policy positions, approved by their respective memberships, calling for states to eliminate excessive and discriminatory taxes on the communications industry and its consumers.

Particularly relevant to today's discussion are two of the policy principles adopted by the NCSL membership in 2000 and reaffirmed in 2004:

- **Tax Equity**: *Under a uniform, competitively neutral system, industry-specific telecommunications taxes are no longer justified.*

- **Tax Fairness**: *With the blurring of distinctions between various services and technologies, state and local governments must strive to set tax burdens on telecommunications services, property and providers that are no greater than those tax burdens imposed on other competitive services and the general business community.*

In 2005, recognizing that efforts to reduce state and local taxes on users of communications services were going nowhere, the National Governors' Association invited the industry and state and local organizations to participate in a new series of negotiations to address the problem. After months of negotiations, it became clear that some of the major local government organizations were unwilling to agree to any reforms that eliminate the authority of localities to impose excessive taxes on communications customers.

The communications industry also worked with individual state legislatures in key states to address the issue. Unfortunately, most of these efforts were unsuccessful. Just in the last year alone, reform bills failed to pass in Florida, Illinois, Oregon, and South Dakota. In Pennsylvania, a bill to repeal the gross receipts tax has passed the House but has been stalled in the state Senate.

The notable exception to this lack of success in reducing excessive taxes is Virginia. In 2006, the Virginia General Assembly passed legislation replacing a myriad of local taxes and fees with a single, state-collected tax imposed at the same rate paid by general business. This reform eliminated local taxes that were as high as 28% on customers in certain cities with a new tax of 5% on all types of communications services. Under this new law, which takes effect on January 1st, consumers of all communications services – wireless, wireline, and cable – will longer pay excessive tax rates on communications services. This legislation could serve as a model for action in other states.

The Economic Impact of Excessive Taxation of Communications Services

There are two separate, but very important, economic impacts that need to be thoroughly analyzed in light of the excessive taxes imposed on communications services. The first is the distributional impact on consumers. The second is the economic impact of excessive taxes on consumer demand and the availability of capital to "build out" advanced communications networks.

There is no dispute that state and local taxes on communications consumers are highly regressive. Simply stated, lower income consumers, e.g., seniors on social security, pay a much higher proportion of their incomes in communications taxes than do higher income consumers. When many of these taxes were first imposed 50 or even 100 years ago, telephone service was considered a luxury only afforded by the rich. Today, communication services are a necessity and other state and federal policies help ensure that every American household has such services at a reasonable cost.

While most consumption taxes are regressive by nature, it is unfortunate when regressive taxes are imposed on a service that society has deemed a necessity. Many states, for example, exempt food from sales and use taxes to mitigate the overall regressivity of the sales tax. Unfortunately, in the case of communications services, consumers in many states face layer upon layer of regressive taxes.

A disturbing trend is making this problem worse. In the last few years, some jurisdictions have imposed flat "per line" taxes, such as Baltimore's new $3.50 per month tax. These taxes take an already regressive tax and make it much worse. In the case of Baltimore, $3.50 per month on a $25 monthly calling plan is a 14% tax rate on that plan but only 3.5% on a $100 monthly calling plan. When the state sales tax of 5% is added on, the consumer on a $25 monthly plan in Baltimore is paying an effective tax rate of 19%! And if that consumer has a family plan with multiple lines, the $3.50 applies to each line. Several wireless providers allow consumers to add an additional line for as little as $9.99 per month. The tax rate on that additional line is a staggering 35%!

Reducing consumer taxes to the same rate charged on other goods and services would not completely eliminate the regressive nature of taxes on communication services, but it would make such taxes much less burdensome on low and fixed income households.

The second issue is the broad impact of excessive taxation on consumer expenditures, company revenues, and the availability of capital for investment in broadband networks.

The economic impact of excessive taxation of communications services has changed as the industry has evolved from a rate-regulated utility model to a competitive model. Both policymakers and technology have driven this evolution.

Under the monopoly model, many state and local taxes were embedded within the rate structure that was approved by regulatory bodies. Most consumers were unaware that these taxes were being collected and remitted to state and local governments. In addition, demand for voice telephone service was not very responsive to price changes, so taxes had very little impact on consumer demand for such service. Also, since company revenues and rates of return were guaranteed by the regulators, excessive taxes did not significantly reduce cash flow available for investment or increase the cost of capital.

In today's marketplace, consumers have competition and choice. They have a choice of providers. They have a choice of many different technologies and platforms. Additionally, since communication services have evolved far beyond just voice communications, consumers also have choices in how to spend their discretionary entertainment dollars.

For example, a technology savvy teenager can communicate with friends by making a call from their home phone or their wireless phone. Perhaps instead they can send a text instant message or a voice instant message. They can call on VOIP service that connects with the public switched telephone network ("PSTN"), or a VOIP service that never touches the PSTN.

The emergence of competition and choice has been a significant factor in subjecting consumer demand for communication services to price sensitivities, with important implications for communications service providers. This means that state and local taxes that add 20% to customer bills reduce consumer purchases significantly. A study by economists Greg Sidak and Allan Ingraham found that each 1 percent increase in the price of wireless service reduces consumer demand by between 1.12 and 1.29 percent. When a state like Florida or New York imposes a 16 percent tax, demand is reduced by as much as 20 percent.

Tax-induced reductions in demand reduce cash flows available for investment in broadband networks. Communications service provider must compete in global capital markets for more costly capital to finance the needed network investment. Quite simply, there is less money to invest in broadband networks that benefit the entire economy due to excessive taxation.

The communications industry plays a critical role in the US economy because of its beneficial impact on the productivity of businesses. A 2005 study by *Ovum and Indepen* found that the information technology, computers and telecommunications services sectors were responsible for 80 percent of the productivity growth in the United States in 2004.

Productivity is simply a measure of output per worker, and strong productivity growth generates important economic benefits. It boosts incomes, living standards, capital formation, and overall economic growth. In the late 1990s, the rapid productivity growth due to the

emergence of the Internet and electronic commerce was widely credited with fueling the robust economic expansion.

Just as the initial development of the Internet was the driver of productivity in the late 1990s, broad deployment of high speed advanced communications networks and applications are the drivers of productivity growth today. Tax and regulatory policies that promote investment in such communications networks and applications will generate important economic benefits. Conversely, policies that increase the cost of investment or otherwise slow investment in communications infrastructure will delay important economic benefits

Consumers benefit greatly from additional investment in communications networks because competition among providers reduces prices. Numerous recent studies have found that broadband penetration in the United States is well behind many of our global competitors. Additional investment in broadband networks will bring high speed networks to businesses and consumers that lack a single provider today, as well as bringing competition and lower prices to businesses and consumers served by one or more providers today.

State and local governments recognize the importance of advanced communications networks because they are subsidizing these networks. Yet at the same time they are imposing excessive consumer taxes that retard the build out of these networks. Reducing taxes on communications consumers to the same rate as general business could have a much more powerful impact on the development of advanced communications networks than direct subsidies.

The Benefits of Fair Taxation of Communications Services

A national policy that requires state and local governments to tax communications services at the same rates as general businesses will have important benefits for consumers and the United States economy.

Lower consumer taxes will eliminate the most regressive elements of the current system, providing immediate benefits to households that need them the most. No longer will our poorest wage earners and citizens on fixed income that rely on communications services for health, safety, and security be subject to excessive and regressive taxation.

Lower consumer taxes will stimulate new investment in broadband networks by increasing consumer demand for communications services, providing more revenues for investment in faster, more reliable, more robust communications networks. Every business and consumer will reap the economic benefits of this new investment. Rural and underserved areas will benefit the most. It is no secret that India and other emerging economic powerhouses have tied their fortunes to broadband communication networks.

In fact, the economic growth that is spurred by additional investments in communication networks will mitigate much of the revenue losses that are keeping states and local governments from eliminating excessive and discriminatory communications taxes. A national policy

providing for fair taxation of communications services is a win for consumers, a win for low income people, a win for rural and underserved areas, and a win for the US economy.

Thank you again, Chairman Cannon and Representative Watt, for holding this hearing today.

Special Report / Viewpoint

The Excessive State and Local Tax Burden On Wireless Telecommunications Service

by Scott Mackey

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Introduction

Nearly four years after the National Governors' Association[1] (NGA) and the National Conference of State Legislatures[2] (NCSL) 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.

Most states have failed to enact meaningful reforms of the excessive taxes on telecommunications customers.

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 and 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 for 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 percent and -1.29 percent,[3] meaning that every 1 percent increase in price reduces demand for the service by between 1.12 percent 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 percent 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 that 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

[1] Scott Paladino, "Telecommunications Tax Policies: Implications for the Digital Age," National Governors' Association, Feb. 2, 2000. Available online at: http://www.nga.org/eda/files/000202TELECOM.PDF.

[2] National Conference of State Legislatures. Policy adopted July 19, 2000, at NCSL Annual Meeting, Chicago. 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: American Enterprise Institute, April 2003. Available at http://www.aei.org/publications/filter.all,pubID.20327/pub_detail.asp.

structure in which 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 has 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 cents per minute to about 10 cents 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, because tax-induced reductions in demand reduce cash flow available for capital investment.

This report 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 method from the 1999 Committee On State Taxation (COST) 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 method and averages local tax rates from the state's largest city and the state's capital city to approximate a state's local taxes. In the case of flat-rate impositions, such as a 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 shows the effective tax rate on wireless customers in 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 (p. 189).

The effective rate of taxation on wireless service increased nine times faster than the rate on other taxable goods and services between January 2003 and April 2004.

The average state and local transaction tax burden on wireless service stands at 8.84 percent, up nearly half a percentage point from the average rate of 8.38 percent at the end of 2002. In contrast, the average state and 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 on wireless service, already significantly above the rate imposed on other goods and services taxable under sales and use taxes, increased nine 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 with 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 (p. 184) shows the different average effective rates for wireless service as compared with the general sales tax, and how those rates have changed between 2003 and 2004.

Table 3 (p. 185) 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 above the national average. Six of the 10 most populated states — California, New York, Texas, Florida, Illinois, and Pennsylvania — are also on the list of the 10 highest tax rates on wireless customers.

State and local tax rates only tell part of the story of the tax burden on wireless service. Wireless carriers are also subject

(Text continued on p. 184.)

[4] Cellular Telecommunications and Internet Association, Washington. Available at http://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* "Vermont Telecommunications Plan," Vermont Department of Public Service, Public Comment Draft, March 2004. Available at http://www.state.vt.us/psd.

[7] "50-State Study and Report on Telecommunications Taxation," Washington: Committee On State Taxation, Sept. 14, 1999 (updated November 29, 2000). (This report was published in *State Tax Notes*, Jan. 8, 2001, p. 99; at *2001 STT 5-34*; and at *Doc 2001-847*.)

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	4.95%	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%
U.S. 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%

(Text continued from p. 182.)

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 is 16.2 percent as compared with 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 with 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) 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]

[8] Paladino, *supra* note 1.

[9] Maine LB 1420 of 2004 (budget bill).

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.

Some of the most onerous telecommunications taxes are local taxes authorized by state statute or imposed through local home rule authority.

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 a 10 percent general-purpose tax on telecommunications service. The city of Clayton, Mo., imposes an 8 percent business license tax for the "privilege" of providing wireless service to a customer located in 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 increased 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

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

	State-Local Tax Rate
California	13.36%
Texas	14.19%
New York	16.23%
Florida	16.12%
Illinois	15.57%
U.S. Weighted Avg.	10.74%

were general sales and use tax rate increases in Arkansas, New York, and 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 General Assembly and the 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, they 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-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, in part, to 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 General Assembly granted Prince George's 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 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, Ore., 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 the city is 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 the industry's ability to generate the revenue necessary to invest in improving wireless networks. The economic development impacts of this potential proliferation of punitive local taxes on wireless customers needs to be examined by 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 the 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 and 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 cent monthly 911 fee — a total effective tax rate of 16.2 percent.[12] By contrast, the combined state and 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 General Assembly 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 Ad-

[10] City of Springfield, Ore., proposed ordinance (unnumbered). *See* "Opportunity to Comment: Springfield Utility Tax," Apr. 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_Rate-Tables0604.xls.

[13] "Simplified Municipal Telecommunications Tax Act." Illinois Compiled Statutes, 35 ILCS 636.

[14] Ohio HB 95, signed June 26, 2003. *See* sections 183 and 186.

visory 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, Congress should take to promote the development of the electronic commerce marketplace in the United States. 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, California State Board of Equalization member Dean Andal (R), 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 4-R Act (Railroad Revitalization and Regulatory Reform 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, such as the NCSL and the NGA, 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 rethink 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 that will face 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 NCSL) 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.

The disparity in taxation between telecommunications services and other goods and services subject to state and local sales tax is not sustainable.

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 nonneutral. 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 experiences 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, and computer-based wireless Internet access; such downloaded products as 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 services, 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

[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 Dubin, and Ken Beier, "Revenue Impact on State and Local Governments of Permanent Extension of the Internet Tax Freedom Act." Washington: Multistate Tax Commission, Sept. 24, 2003. (This report was published in *State Tax Notes*, Oct. 6, 2003, p. 75; at *2003 STT 193-9*; and at *Doc 2003-21777*).

[18] Cline, Robert. "Critique of Multistate Tax Commission's State and Local Revenue Impact Estimates of H.R. 49." Washington: Ernst & Young LLP, Oct. 1, 2003. (This report was published in *State Tax Notes*, Oct. 27, 2003, p. 317; at *2003 STT 207-4*; and at *Doc 2003-22800*.)

different than digital products that are downloaded 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 nontaxable 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 in which 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 (VOIP). Needless to say, however, the taxation of VOIP raises some of these same issues and some additional issues as well.[19] All of 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 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 on 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 phaseout 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 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 phaseout of excessive telecommunications taxes. Such a phaseout 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 when excessive taxes are phased out.

State and local government successes with the Streamlined Sales Tax Project (SSTP) may also provide another unique opportunity for states to transition away from excessive telecommunications taxes. The SSTP is a multistate 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 establish a system that would provide incentives for multistate 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

[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, *supra* note 2.

[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/TSS0404.pdf. Also, Nicholas Jenny, "State Revenue Growth Gains Momentum." Albany, N.Y.: 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. (A report by Jenny on the state revenue recovery appeared in *State Tax Notes*, July 12, 2004, p. 103; at *2004 STT 133-1*; and at *Doc 2004-13385*.)

states may be inclined to exclude some telecommunications taxes from the SSTP simplification provisions.

Conclusion

State and local governments have made very little progress in reforming excessive telecommunications taxes over the last five years. However, the convergence of new communications technologies, including VOIP, 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.

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.

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 cents per month
	Total Transaction Tax	**7.45%**	
Alaska			
##	Local sales tax	2.50%	Avg. of Juneau and Anchorage
	Local E911	1.55%	up to 75 cents per month
	Total Transaction Tax	**4.05%**	
Arizona			
##	State sales (transaction priv.)	5.60%	Intrastate telecommunications service
	Local sales (transaction priv.)	4.70%	Avg. of Phoenix and Tucson
	911	0.76%	37 cents per 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. of Little Rock (1.5%) and Fayetteville (3.25%)
	State USF	0.80%	Intrastate
	Wireless 911	1.03%	50 cents per month statewide; local 911 — up to 30 cents per month effective September 1, 2003
	Total Transaction Tax	**10.21%**	
California			
##	Local utility user tax	8.75%	Avg. of L.A. (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
	CTP	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 and Colorado Springs
	Local sales — RTD , CD , BS	0.80%	Denver and surrounding counties only
	911	1.02%	Up to 70 cents per month plus overrides
	USF	2.00%	Set annually based on fund status — reduced January 1, 2003, from 2.3%
	Total Transaction Tax	**9.37%**	
Connecticut			
##	State sales tax	6.00%	Access, interstate, and intrastate
	911	0.41%	20 cents per month
	Total Transaction Tax	**6.41%**	
Delaware			
##	Public utility gross receipts tax	4.25%	Access and intrastate
	Local 911 tax	1.24%	60 cents per month
	Total Transaction Tax	**5.49%**	
District of Columbia			
##	Telecommunication privilege tax	11.00%	11% effective January 1, 2003 — access, interstate, and intrastate
	911	1.57%	76 cents per month
	Total Transaction Tax	**12.57%**	

(Appendix A continued on next page.)

(Appendix A continued)

State	Type of Tax	Rate	Notes
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 cents per 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 of Fulton and 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%	0.25% of intrastate
	Total Transaction Tax	**6.14%**	
Idaho			
##	Telephone service asst. program	0.17%	Set annually by PUC — currently 8 cents per month
	Statewide wireless 911	2.07%	Local — up to $1 per month effective July 1, 2003. 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 and Springfield
	Wireless 911	2.07%	Chicago $1.25 per month; others 75 cents per month
	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 set annually by board
	PUC fee	0.15%	
	Total Transaction Tax	**9.62%**	
Iowa			
##	State sales tax	5.00%	Access and intrastate
	Local option sales taxes	0.50%	Avg. of Cedar Rapids and Des Moines
	Wireless 911	1.03%	Up to 50 cents per number
	Total Transaction Tax	**6.53%**	
Kansas			
##	State sales tax	5.30%	Intrastate and interstate
	Local option sales taxes	1.45%	Avg. of Wichita and Topeka
	USF	3.57%	4.99% of revenues x 71.5% FCC intrastate safe harbor
	911 fee		Effective July 1, 2004; 25 cents per state and 25 cents per county
	Total Transaction Tax	**10.32%**	
Kentucky			
##	State sales tax	6.00%	Access, interstate, and intrastate
	School utility gross receipts	1.50%	Avg. of Frankfort (3%) and Louisville (0%)
	Lifeline support charge	1.03%	50 cents per month Frankfort and Louisville
	Wireless 911	1.45%	70 cents per month
	Total Transaction Tax	**9.98%**	
Louisiana			
##	State sales tax	3.00%	Access, interstate, and intrastate
	Wireless 911	1.39%	New Orleans 85 cents per month; Baton Rouge 50 cents per month
	Total Transaction Tax	**4.39%**	

(Appendix A continued)

State	Type of Tax	Rate	Notes
Maine			
##	State sales tax	5.00%	Intrastate
	911 tax	1.03%	50 cents per month effective July 1, 2003
	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 and Annapolis
	State 911	0.52%	25 cents per month effective Oct. 1, 2003
	County 911	1.55%	Up to maximum of 75 cents per month effective Oct. 1, 2003
	Total Transaction Tax	**7.07%**	
Massachusetts			
##	State sales tax	5.00%	Interstate and intrastate
	Wireless 911	0.62%	30 cents per month
	Total Transaction Tax	**5.62%**	
Michigan			
##	State sales tax	6.00%	Interstate and intrastate
	Wireless 911	1.07%	52 cents per 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 and St. Paul
	911	0.83%	Max. 40 cents per month effective July 1, 2003
	Telecom access MN fund	0.28%	Up to 20 cents per month set by PUC — currently 13 cents per month
	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 Jefferson City and 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 cents per number per month
	TDD tax	0.21%	10 cents per number per month
	Total Transaction Tax	**4.99%**	
Nebraska			
##	State sales tax	5.50%	Access and intrastate
	Local sales tax	1.50%	Up to 1.5%
	State USF tax	6.95%	Intrastate service revenue
	Wireless 911	1.03%	50 cents per month
	TRS	0.14%	7 cents per month effective January 1, 2003
	Total Transaction Tax	**15.13%**	
Nevada			
##	Local franchise/gross receipts	0.62%	2% of first $15 of intrastate revenues
	Local 911 tax	0.52%	Up to 25 cents per month — imposed by counties

(Appendix A continued on next page.)

(Appendix A continued)

State	Type of Tax	Rate	Notes
Nevada (continued)	State deaf relay charge	0.17%	8 cents per month — effective July 1, 2003
	Total Transaction Tax	**1.14%**	
New Hampshire			
##	Communication services tax	7.00%	Access, interstate, and intrastate
	911 tax	0.87%	42 cents 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. of Santa Fe and Albuquerque
	Wireless 911	1.05%	51 cents 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 and Albany
	MCTD sales tax	0.13%	NYC 0.25%; Albany 0% (COST)
	State excise tax (186e)	2.50%	Mobile telecom service — includes interstate
	MCTD excise/surcharge (186e)	0.30%	NYC and surrounding counties — 0.6%; 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 cents per month — NYC and selected cities
	MCTD surcharge (184)	0.07%	NYC 0.13%; Albany 0%
	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 cents per month
	Total Transaction Tax	**7.65%**	
North Dakota			
##	State sales tax	5.00%	Access and intrastate
	Local sales taxes	1.25%	Avg. Fargo and Bismarck; includes Cass County
	State gross receipts tax	2.50%	Interstate and intrastate
	Local 911 tax	2.07%	Up to $1 per month
	TRS	0.12%	Up to 11 cents per month — currently 6 cents per month
	Total Transaction Tax	**10.94%**	
Ohio			
##	State sales tax	6.00%	Access, interstate, and intrastate
	Local sales taxes	1.63%	County and transit taxes — avg. of Columbus and Cleveland
	Total Transaction Tax	**7.63%**	
Oklahoma			
##	State sales tax	4.50%	Access, interstate, and intrastate
	Local sales taxes	3.65%	Avg. of Oklahoma City and Tulsa
	911 tax	1.03%	50 cents per line
	USF	0.40%	Intrastate
	Total Transaction Tax	**9.58%**	

(Appendix A continued)

State	Type of Tax	Rate	Notes
Oregon			
##	911 tax	1.55%	75 cents per month
	TDD/low income subsidy	0.72%	Up to 35 cents per month — currently 13 cents per month
	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%	Philadelphia and Pittsburgh 1%; other locals 0%
	Statewide wireless 911	2.07%	$1 per month — effective April 4, 2004
	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 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 and Rockland County
	Municipal license tax	0.30%	0.3% of monthly recurring charge (max. 0.75% on January 1, 2004)
	911 tax	1.20%	58 cents per 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 July 1, 2003
	Local option sales tax	2.00%	Up to 2% — COST methodology
	911 excise	1.55%	Up to 75 cents per month
	TRS fee	0.31%	15 cents 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 and Davidson counties
	911 tax	2.07%	Up to $2 statewide — $1 currently imposed
	Total Transaction Tax	**11.57%**	
Texas			
##	State sales tax	6.25%	Access, interstate, and intrastate
	Local sales tax	2.00%	Avg. of Austin and Houston
	Telecom infrastructure fund	1.25%	Statewide on sales tax base
	Wireless 911 tax	1.03%	50 cents 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 per month — SLC rate used
	911 tax	1.10%	53 cents per month
	Poison control	0.14%	7 cents per month
	State USF	0.34%	Intrastate revenues
	Total Transaction Tax	**10.25%**	

(Appendix A continued on next page.)

(Appendix A continued)

State	Type of Tax	Rate	Notes
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 per month) and Virginia Beach ($3 per month)
	Wireless 911	1.55%	75 cents per month
	Total Transaction Tax	**7.75%**	
Washington			
##	State sales tax	6.50%	Access, interstate, and intrastate
	Local sales tax	1.90%	Avg. of Olympia and Seattle
	B&O/Utility Franchise — local	6.19%	Olympia and Seattle avg.
	911 — county excise	0.41%	20 cents per month effective January 1, 2003
	911 — state	1.03%	50 cents per month effective January 1, 2003
	Total Transaction Tax	**16.04%**	
West Virginia			
##	Wireless 911	1.94%	94 cents 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 and Madison
	Total Transaction Tax	**5.55%**	
Wyoming			
##	State sales tax	4.00%	Access and intrastate
	Local sales tax	1.00%	Avg. of Cheyenne and Laramie
	TRS	0.12%	Up to 25 cents per month — 6 cents per month currently
	USF	4.00%	Access and intrastate
	911 tax	1.55%	75 cents per month statewide effective July 1, 2003
	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 and Kimbell Sherman Ellis using state statutes.

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The Forum for America's Ideas

TELECOMMUNICATIONS TAX REFORM

EXECUTIVE COMMITTEE TASK FORCE ON STATE AND LOCAL TAXATION OF TELECOMMUNICATIONS AND ELECTRONIC COMMERCE

WHEREAS, the elimination of boundaries, new technologies and increased convergence and competition in telecommunications makes it critical to simplify and reform state and local taxes to ensure a level playing field, to enhance economic development, and to avoid discrimination; and

WHEREAS, until 1984, telephone service was a highly regulated service generally subject to tax under statutes applicable to "public utilities"; and

WHEREAS, such taxes in the form of gross receipts, franchise and other industry-specific taxes were passed on to consumers as part of the regulatory rate setting process; and

WHEREAS, convergence and technology have radically expanded telecommunications, blurring distinctions between telephone and Internet service in some instances; between cable, wireless, satellite, and wireline; between long distance and local service and between telephone and other forms of communications and information services;

WHEREAS, in most states, the deregulation of the industry was not accompanied by corresponding elimination, simplification, or restructuring of taxes that have historically been levied on regulated companies; and

WHEREAS, the combination of state and local taxes and fees imposes significant administrative costs on telecommunications companies, most of which operate in multiple states and localities; and

WHEREAS, this administrative burden forces such companies to incur substantial expenditures to satisfy compliance and systems requirements, resulting in higher costs of service for consumers without any corresponding benefit to state or local governments; and

WHEREAS, state and local tax burdens on telecommunications companies and their customers are significantly above those imposed on most other types of industries and services; and

WHEREAS, imposing these higher tax burdens on telecommunications services provided by "telecommunications providers" while imposing lower and even no tax burdens on similar services sold by non-traditional providers places governments in the position of picking winners and losers in the marketplace; and

WHEREAS, enhanced access to advanced telecommunications provides important economic, safety, and social benefits to citizens and businesses in the new, global economy; and

WHEREAS, high administrative costs and tax burdens imposed on the telecommunications industry create an impediment to entry for new service providers, disincentives to deploy infrastructure and increase the cost to consumers of access to advanced telecommunications services.

NOW, THEREFORE BE IT RESOLVED THAT, the National Conference of State Legislatures encourages states to work together with local governments and providers in their efforts to simplify and modernize state and local taxes on telecommunications based upon the following principles:

1) **Tax Efficiency:** State and local taxes and fees imposed on telecommunications services should be substantially simplified and modernized to minimize confusion and ease the burden of administration on taxpayers and governments.
2) **Competitive Neutrality:** State and local transaction taxes and fees imposed on telecommunications services should be applied uniformly and in a competitively neutral manner upon all providers of telecommunications and similar services, without regard to the historic classification or regulatory treatment of the entity.
3) **Tax Equity:** Under a uniform, competitively neutral system, industry-specific telecommunications taxes are no longer justified.
4) **Tax Fairness:** With the blurring of distinctions between various services and technologies, state and local governments must strive to set tax burdens on telecommunications services, property and providers that are no greater than those tax burdens imposed on other competitive services and the general business community.
5) **Local Government Impacts**: States need to include provisions to mitigate potential local government revenue impacts associated with telecommunications tax reform.
6) **Economic Development:** States need to simplify, reform and modernize state and local telecommunications tax systems to encourage economic

development, reduce impediments to entry, and ensure access to advanced telecommunications infrastructure and services throughout the states.

7) **State Sovereignty:** NCSL will continue to oppose any federal action or oversight role which preempts the sovereign and Constitutional right of the states to determine their own tax policies in all areas, including telecommunications.

Unanimously adopted by the NCSL Executive Committee Task Force on State and Local Taxation of Telecommunications and Electronic Commerce on Monday, July 19, 2004.

Unanimously adopted by the full NCSL Executive Committee on Tuesday, July 20, 2004.

Mr. CANNON. We will recess for about 20 minutes. Long enough to go over and vote. Then when I get back, we'll restart. So we will be recessed for a bit. Thank you.

[Recess.]

Mr. CANNON. The Subcommittee will come to order. All this technology going on here. Modern communications are fixed to the floor and worse, we have noise from the floor.

I think—Steve, do you want to stay for a question?

Thank you. We have another briefing going on elsewhere, so I think we'll do questions. I'll ask you questions and we will be a little less formal here, but I'd like to get up to that briefing as well.

I apologize for that, the interruption. That's sort of what happens in Committee. But we had some really interesting discussion, and what I'd like to do is just get comments from the various perspectives on this issue. Historically, the richest guys in town were the guys who had the telephones first and they got to call each other and the maids got to call the maids in other houses. You had somebody who actually physically pulled the plug and put it in so you connect to the circuit. And so we taxed people pretty heavily on telecommunications because it was a luxury.

The world has changed around us now. We don't—not only do we not have plugs, but we don't have circuits any more. We have the Internet and communication on the Internet.

I am wondering if given the regressive nature, and certainly you'll testify on this, but I'd like to focus on the regressive nature of the tax as telecommunications has become so common. Is that not something that ought to concern us significantly. We'll start Steve, with you and go down the panel.

Mr. RAUSCHENBERGER. Absolutely it should. The aggressive nature of telecommunications taxes is a problem. Because the rate's high. Because consumption tends to, on traditional phone lines, tends to be more concentrated in less affluent socio-economic groups. And the other thing that we didn't touch on but I think has been stated—the concept emerging since the '20's and the '30's, the 1920's and 1930's in the United States of a ubiquitous network where everybody's connected. The value of the network is, in large measure, because everybody is on it. I mean having a phone system that only connects half of the Members of Congress is less valuable to everybody. So these extraordinarily high taxes also discourages some people from being on the network.

Mr. CANNON. Thank you. That's a remarkably important insight and I appreciate that. I don't mean to interrupt, particularly, but if you could add to the commentary. You might, in particular, want to talk about this. It seems to me the wonderful thing about America is we have upward mobility. The ideas of Americans that we have is that rights come from God, individuals delegate those rights to Government, and we protect those rights through the rule of law. And in that environment, it doesn't matter who your poppi was, you know. It doesn't matter where you were born or the color of your skin. What matters is your initiative and your intellect and other talents.

And so in America, we have this upward mobility that's created by a system. No other country—I mean, there's been stories about China for instance, where they would seek out the smartest kids

in the country, bring them into the bureaucracy and the bureaucracy is what actually maintained and developed upward mobility but it was very, very limited. Whereas in America, any kid can fail his test here and there and not do well, but finally get some initiative and make something out of himself.

It seems to me that telecommunications is like a key factor in letting that kid get an education, assert himself, connect himself and move up. And am I missing something here but isn't that an important part of it?

Mr. RAUSCHENBERGER. I would agree. I would again say the danger we have in not dealing with this traditional silo tax and regulatory scheme and simply avoiding doing it because it's uncomfortable. It causes us to rethink how we do municipal taxation or rethink how we do State taxation. There's no long-term benefit to the United States or to any municipality or State not reforming these.

So that's why—if you are going to have a network of exchange of information, if intellectual property is going to be one of the cornerstones of my children and your children, and the United States has to build on as we compete in an ever-increasing flattened world. We need to make sure our networks are ubiquitous, that they're low costs, that they're broad based and they're well distributed, and our tax policy today does not—you know, I believe in the sovereign States.

I am a States' rights person. We need to work with the municipalities and the States to make sure we do this right. But we do need leadership on some issues from Congress to help set time frames.

Mr. CANNON. And when you talk about a ubiquitous network what you're talking about there is not only the whole system where you better but the ability of kids or individuals to emerge in the system. The record should reflect that Senator Rauschenberger is nodding his head in the affirmative on that. Thank you.

Mr. Kranz, or Mr. Quam——

Mr. QUAM. I'd be happy to take that. I think you definitely hit on an issue I think everybody here recognizes in that we have a legacy problem that our tax laws are not keeping up with some of the technological evolutions that we've seen. Some of which have been evolutionary, if not revolutionary, just in the last 6 years. The Internet, in particular, is now the cornerstone in communications. This is no longer just wireline and pack switches and that type of thing. And so States do need to reform and take a look at the regressivity of some of the taxes and the entire tax system as a whole. However, one of the things I pointed out in my testimony—one of the things that was critical during our discussions, was bringing everybody to the table.

Again, this is not telecommunications anymore, this is all communication services. You have what has traditionally been defined not as telecommunication—telecom now offering telecom type services. So if you are talking about reform of the tax system, and again, States are really beginning to look at reform at the State level where you can broaden the base and lower that rate and possibly address some of these legacy issues. You need to get rid of some of the restrictions that prevent States from being able to

broaden that base so that you can craft a solution that really works at the State level.

I go back to the example in Virginia. Again, during that process, which took a number of years, they reached out to local government groups, all sorts of different industry groups. Crafted a bill, established a rate, ran the tax numbers to see if the revenues would be sufficient to make municipalities whole and get the revenues that the State needed, and also meet some of the competitive neutral aspects that they were after. When it didn't, they went back out, tried to bring, you know, talk to other industries, brought them in to the point where you have a very comprehensive bill that really could revolutionize State and local tax structures in Virginia.

Now, it's important to note that that model can't be used everywhere. Not every State is going to have the options that Virginia did as far as moving taxes, increasing them some places, lowering them in others. But the dialogue at the State level, State and local level, and I would argue at the Federal level, has got to be now, not about telecommunications taxes but about communications, the entire industry. Ultimately, reforms should be future proof, and I want to borrow a phrase from one of my friends in telecom that said if we do that right, you get to reforms where the next new entrant and the next new thing fits seamlessly in there and provides opportunities for everybody to use that technology and taxation is no longer picking and choosing winners and losers, but it is also meeting the needs of State and local government.

Mr. MACKEY. Just briefly, Mr. Chairman. I absolutely agree that we ought to be concerned with the regressivity. As you mentioned, obviously, the networks are ubiquitous, but you also have, you know, the demographics are changing in terms of who's using and purchasing a lot of these services, and you alluded to it in your opening statement about the kids doing the text messages back and forth and you having to try to keep up with your kids doing it.

I mean, we have got a lot of young people, a lot of people on fixed incomes staying connected through this technology in a lot of different ways, not just through voice. So it's absolutely important and critical that we look at it. So I would agree 100 percent.

One other thing, if I can tie it back to something I said earlier, to the extent that—and this relates to the prices that folks pay for communications services. To the extent that we have tax policies that slow the emergence of competing networks so that we have one provided by a cable company and one provided by a landline company and one provided by a wireless company, and others all able to provide broadband, to the extent we slow that, consumers are denied the benefits of competition, which are also going to lower the price that consumers have to pay for those services.

So there's the impact of the regressive taxes and slowing of investments that's going to bring lower prices for everybody as well.

Mr. CANNON. Thank you. I have another couple of questions, but my time has expired.

Mr. Watt.

Mr. WATT. Mr. Chairman, I always like these hearings because we spend all that time arguing about things that I think everybody already agrees on. Taxes are too high, taxes shouldn't be regres-

sive, taxes are unfair, State to State is inconsistent. I think pretty much everybody on the panel said that in one way or another.

The point I am wrestling with, I don't even disagree with any of that, is how the Federal Government gets there from here and what our standing is to be setting a standard. And so I guess my devil's advocate question, not to try to get to a different conclusion than you all—I mean, Senator Rauschenberger said that we need to do something to provide incentives to, quote, enlighten State public policymakers. Recognizing that there are some enlightened State public policymakers, the problem is it sounds to me like they are all moving in the direction and all of a sudden the Federal Government is getting ready to do something preemptive, or runs that risk.

So I am trying to figure out how we don't stifle those enlightened State public policymakers, but don't overstep our bounds at the same time, because if you accept the notion that interstate commerce—and this is one of those—telecommunications, I guess, is interstate commerce—but if you accept the notion that the Federal Government can preempt, and the next step is going to be no taxes on telecommunications, I don't know how you get off that slippery slope. I don't know how you get from the notion that you can do this on interstate telecommunications, but there is still some intrastate, and I'm not sure what authority we have as Congress to do this.

So I'm going to encourage you all—I'm going to stop talking and encourage you all to have a discussion about some of the things that we need to be focusing on, not the things that we all agree on. Everybody will tell you taxes are too high, but I'm sure Senator Rauschenberger is not going to tell you that the State doesn't have the authority to set its own tax structure, and I'm sure the local government is not going to tell you that we've got to at least have some revenue coming from somewhere if we're going to provide local services. And at some point we've got to come to grips with who has responsibility and authority to make these assessments, and you all keep talking about providing incentives, or speeding up, but I haven't heard anybody say where you think we ought to get off, because once the Federal Government gets on, we don't have much of a history of getting off of anything.

That's my question. Whoever wants to answer it.

Mr. RAUSCHENBERGER. Congressman, thank you for asking that question. Two quick observations. Enlightened legislators, State legislators, is not the same as military intelligence. Sometimes it really does exist. I think State public policy is moving in the right direction, but so are the glaciers in Greenland.

I think at risk here is the speed that we need to understand that we operate today 16th- and 17th-century Governmental models which served the public well——

Mr. WATT. The States are operating under those same models. The Federal Government is still operating under some of those same models, too. So that doesn't answer my question.

Mr. RAUSCHENBERGER. Which is why public policy falls behind.

I would make three recommendations to you. First of all, I think preemption is a dangerous place to go, but if the Federal Government or the Congress were to consider putting out there a set of

guidelines and recommendations to States, much like they did with the Mobile Sourcing Act where there was a requirement that States over a period of time act to modernize their sourcing rules or they lost the ability to levy those taxes. In the end, we had 50-State compliance because people had time to react to it. It set an agenda for State legislators.

I would also recommend that as this Committee looks at it, you need to consider defining communication services broadly enough that State legislatures can broadly tax all communications services at a lower rate rather than focusing on some technologies. The concept that Voice Over Internet Protocol or Internet speech ought to somehow be treated differently than wireline communications is not something I think is in the public's best interest in the long run.

I think also I would recommend, whatever you do, that you allow sufficient time frame, keeping in mind that some State legislatures still only meet every other year. I would argue 4 to 6 years at the minimum, is the shortest time period to mandate to work with the States to modernize because some legislatures don't meet often enough.

The last thing I would urge you to consider in this short laundry list is the understanding that States are going to have a difficult time mitigating the impact on local governments. So giving States resources to work with; for example, I have always believed that the best opportunity to actually get telecommunication tax reform done at the States, is simultaneous with modernization of State sales taxes in the streamline bill where there's resources from the modernization of the sales tax occurring simultaneous with the loss of revenue in telecommunications. So we can improve both those tax systems.

Mr. KRANZ. Mr. Chairman, Representative Watt, I think if you take the problems we've described and break them down into two separate pieces, the tax rate burden and the discrimination that occurs there and the administrative or, as I call it, the accounting burden, those two problems can be solved with very different solutions. And the rate burden, the discrimination, there are models out there, the 4R Acts that Congress passed, preventing States from discriminating against transportation companies in their taxing positions. There's a markup later this afternoon on a bill that would prevent States from discriminating in natural gas pipelines.

That's the kind of Federal solution that could be crafted here, and my job isn't to advocate any solution. Our study is intended to discuss the lay of the land out there.

On the administrative or accounting burden, a solution could be fashioned at the Federal level similar to what State Senator Rauschenberger mentioned in the streamline bill. There Congress can provide a carrot incentivizing the States to get to a simpler world.

Those are possibilities that I think should be considered. I know that our friends at the State level don't want Federal solutions to these problems, but I do agree that the icebergs in Greenland are moving faster.

Mr. QUAM. Mr. Watt, I am going to, surprise, surprise, disagree with some of my panelists. Having the Federal Government some-

how proscribe a solution here or preempt the States in coming out and asking for that as a potential solution seems to be saying, please help States—please save us from ourselves.

The last time I checked, States and local officials, they answer to voters, and they are subject to elections, and they are making those decisions. That's ultimately where State and local tax decisions need to remain.

In my testimony I mentioned that one of the biggest things Congress could do in this field, because States are reforming taxes, is support modernization by just avoiding Federal action that will restrict the ability of States to craft meaningful reforms.

I get back to one of the best ways to ultimately allow States to reduce rates, if that is an ultimate goal, is to be able to broaden the base and create some tax equity and some competitive neutrality among competitors. I think that is a worthy goal, but a goal that has to be pursued at States.

Finally, I think Senator Rauschenberger is right on the mark with regard to streamlined. The streamlined bill has been a remarkable effort by States on a volunteer basis to modernize sales tax systems, to address an incredibly complex systems of sales tax laws, find agreement and work together in a sovereign way, because it's States making State decisions and working together and ultimately having the Federal Government support that effort and partner with States I think will be a large step forward with regard to taxes and promoting that type of simplification, administrative simplifications.

Mr. MACKEY. Mr. Chairman, Mr. Watt, just briefly. The problem is I think if we just say just leave it to the States, I mean, we have a history of about 10 years where everyone has said there is a problem, and we've had, as others have said, very little movement.

I absolutely agree that the federalism issues are very tricky, and you guys are drawing that line, but, I mean, Congress is uniquely, I hope, positioned to look at the broader economic issues of balancing federalism between the national economy and some of the impacts that some of these taxes are having on our ability as a Nation to compete globally and to get the networks out as quickly as possible. That is a difficult balancing act. Certainly if this were an easy thing for States to do, more would have done it.

I guess the problem from the communications industry side is just that it's difficult and frustrating when everyone agrees that there's a problem, and there is not much action or no action, or, I guess, one State moves to fix it.

That's the dilemma that we face, and we're glad that you guys are having this hearing so we can talk about some of these issues, and you can weigh where you come out on that balancing act.

Mr. CANNON. Thank you. Without objection, we'll go to a second round of questioning.

Mr. Watt just asked pretty much my second question that I wanted to talk about. Let me refine it now a little bit, because I am highly reluctant to preempt States. On the other hand, there are some issues that really cry out in our constitutional environment for Federal national policy.

I think, Mr. Mackey, you talked about the value of the network, in fact, several talked about the value of the network, being more

valuable as more people get involved, and to the degree that that network becomes a huge national asset. And, in fact frankly, the foundation for the wealth not only of America, but for the rest of the world, it seems to me that that cries out for national policy in a world where any given State can distort that network fairly substantially.

Does anyone want to comment on that with particularity? If you say it, it's better in the record than if I say it.

Mr. RAUSCHENBERGER. Let me say again, whether you are talking about the first intercontinental rail system, the movement toward standard gauges for railroads in America, or the National Highway System where States surrendered small parts of their State sovereignty—we all agreed lane width would be 13½ feet, yellow paint would separate oncoming lanes of traffic—those networks have always had more value because there was consistency and leadership at the Federal level. No governor and no mayor is in a position not to see from 30,000 feet the value and the importance of being part of a ubiquitous, seamless network.

For Congress to set a 6- or an 8-year reasonable deadline requiring States and local governments to reform and bring their tax system into compliance so they don't discriminate against a particular type of technology does not seem to me to be overly intrusive. I don't think any of us are suggesting here that we manage the network from the Federal Congress.

We're talking about what everybody agrees is clearly a discriminatory taxing system that's affecting this network, which we all agree has value. I think your point is on target.

Mr. QUAM. Mr. Chairman, I see a fundamental difference between sort of highways and railroads and the role they played and the network they served when they were being built and what we look at today. You're absolutely right, the value of network is absolutely proportional to the number of people on it, no question about it.

No one would say, however, that the wireless industry has somehow not been successful in the last 10 years when you look at the number of subscribers. No one would argue that some of the large Bell companies who are investing in fiberoptics and broadband and aggressively going out there aren't competing and competing well and competing at the highest levels. The COPE Act itself is about establishing market-based reforms to increase that competition.

When you're talking about the railroads and the highways and a national presence, that was needed in some sense just to get the roads built, just to get them across the States. We have networks in place right now; I can go buy a roaming plan, and my phone will work anywhere in the United States. That's a pretty robust network.

The question becomes, Mr. Watt, I think you said yourself, the commerce clause gives Congress very wide authority, and arguably communications is interstate, and we give Congress wide authority to come and interfere with State and local taxation. However, the question has got to be should Congress interfere with that. I think the 10th amendment ultimately means that's got to be a very high bar to cross.

Mr. WATT. I think the question is where you draw the line.

Mr. QUAM. I think that's absolutely right.

Mr. WATT. That's really the question. What you're doing is making the case for a Federal taxing system. That's probably more understandable than the argument you're making. I don't see—I don't see a compelling Federal argument to provide an incentive to do this in 6 years. I see a more competitive, compelling argument that the Federal Government could take it over completely and say don't tax it. That's what we did with the Internet.

But you're on a slippery slope, and I'm just suggesting that you need to be careful, and even there I don't know how you say to a State and local government you can't tax local phone calls, local communication. That's not——

Mr. CANNON. That's my next question. You're asking exactly the questions that I think need to be asked, but can I just add a little bit? We have already decided not to tax the Internet, and we are talking about being neutral to technology. So, how do we tax telecommunication systems when you have a system that we're already agreed on a national level, with some exceptions, not to tax?

There's been some talk, I think that's where you're headed, and I'd like to get the opinions of these folks. Should we tax the telephone number? Because if you tax a telephone number, people will go to URLs, and that will clog a system that people have come to enjoy. In other words, if you are going to be technologically neutral, don't you need Federal leadership; and secondly, don't you need to get away from taxation entirely of a system that is fundamental?

We tax gasoline. We don't tax, except in cases like Utah, and they are under the process of thinking about being stupid on this point—we don't tax except generally speaking through gasoline taxes.

Doesn't it make some sense to not tax communications because that's the only way you are going to be technologically neutral; and secondly, don't you need Federal leadership to actually do that?

Mr. WATT. Except you should know for the Chairman it makes sense not to tax anything.

Mr. CANNON. Very little.

Let's start with Mr. Mackey and move back, because, Steve, you may want the last word on this one.

Mr. MACKEY. That's a policy question that people would argue about. I think what the industry is seeking on behalf of its customers is fairness, and fairness defined as we're not seeking to be exempt from all taxes. We feel like the services that the communications services industry provides, which, after all, are moving more and more away from plain vanilla talking on a telephone and more toward a lot of digital goods and other types of services that are really no different than sometimes what you buy at a store, whether you buy a CD in a store or download it onto your phone or onto your computer at home—we think that the industry would argue that fairness means being taxed like general business. Now, from an economic development maybe you can make the argument that the rate should be zero. This industry, communications industry, has been subject to a discriminatory burden for so long that we just want to get to where general business is. And we think there are significant economic benefits to the economy of doing that

that, as I said earlier, will generate some money at local governments to help them fill in some of what they think they are losing.

Mr. CANNON. Mr. Mackey, do you know how many users Skype has today? Last I heard, it was 28 million, but it's probably doubled since then, 30, 40 million. Does anybody know? In other words, we have something like 98 million landlines, something like 100 million cell phones. Skype is now in the ballpark of those. They are not taxed.

So I appreciate the fact that you're willing to take the stripes of the normal tax burden here, but the normal tax burden is not going to be normal for a year or 2 longer.

Mr. MACKEY. I'll quickly follow up. To the extent you maintain the high rates, you are just driving everyone to the type of system you're talking about with them.

Mr. CANNON. Pushing the envelope a bit because I want some feedback, we are rapidly becoming a system where not only is the discriminatory tax outrageous, counterproductive, but any tax is going to be marginalized by technology. So don't we need Federal leadership on probably a quicker scale than you are suggesting, Senator Rauschenberger, to deal with this issue so America maintains its leadership and expands at a rate unencumbered? And, of course, it does create a problem for States; I'm not suggesting it does not.

Mr. QUAM. Mr. Chairman, it won't be surprising that I'm going to be contrary.

Mr. CANNON. When you disagree, would you tell me what we do about taxing VOIP? I think taxing a phone number is silly. That's probably what we do in the Senate with the COPE Act. I think it's a stop-gap, and I hope the States think about how we get away from that quickly enough so we don't distort the system. That's what I'd really like to hear from you. What do we do to tax Skype in a way that is not counterproductive to the development of the Internet and communications services generally?

Mr. QUAM. Right now, and somebody can tell me if I'm wrong, I believe Skype is a free service. Some of it is. So it's more or less a free service. So forgetting the tax, you also have a free service compared to other communications. So there are a lot of economic factors involved in why Skype might be growing the way it is.

More importantly, I want to get back to an important key point, and this is the hearing and what you're talking about is State and local taxation, it's not Federal taxation. The Federal Government certainly can and should be a leader with regard to Federal tax policy. I don't think the Federal Government has to lead when it comes to State and local tax policy.

Mr. CANNON. Would you deal with the issue of the national policy toward telecommunications, communications, Internet, all the bundle of things? In other words, if you say historically we don't have a right to deal with local taxation of particular items, well, we have constitutional issues that we've developed over a long period of time, but we are not talking in a context. Now we're talking about a future in which communication can be virtually free, and that means free of taxes and in some cases free of even cost other than the access to the bandwidth.

The question in my area is now selling mostly bandwidth and other things that go along with bandwidth. That's where they view their financial future. And whatever services, whether that's telecommunication or television, cable content or video conferencing, they just want to get money—in other words, the industry is saying we want value for what we provide, we don't care what it is that you do.

So telecommunications, if you take an arbitrary identifier like a telephone number, becomes an obstruction to the development that might otherwise just happen, and the States are in the middle of that, and we're looking at that from a national policy view.

What do we do to distance ourselves in the areas of innovation and communication? That's what I think I need to hear from you, not that the States have rights, because they do. But what do we do as a country so we go in the right direction, and what is the most important economic force in the world today?

Mr. QUAM. I get back to, again, the point that was made when we gathered all of our players for the discussion. That was an issue I talked about before, and that is future-proofing, which is really what you're talking about, the vision for the future that will allow for the growth of new technologies, new entrants, new paradigms really, and how do those match up with Government responsibilities, ultimately.

The Federal Government certainly has a role in planning Federal policy to do that. I don't disagree. Do I have the answers? No. I don't think anybody in this room does, but it could be one heck of a debate.

My issue remains that at the end of the day States do have rights, States do have responsibilities, States do have public interest that they need to enforce, and sovereignty means something, and revenues do matter.

To the extent that the Federal Government interferes with those State tax systems, I think that's a very high bar to cross. Establishing a national standard with national resources, absolutely, that's Congress's prerogative. But when you cross into the State line, and I think we can be good partners, and States can be innovators and will be innovators moving forward.

Mr. CANNON. Mr. Kranz, you have something to say?

Mr. KRANZ. The communication companies are inevitably in a national playing field. Whether they're traditional telecom companies, cable companies, the Skype or the Vonage that are selling communication services online, they are in a national playing field, and I think we've identified—and I hate to use the phrase, but we've identified two nonlevel portions of that playing field, and one is communication companies competing with other communication companies and the disparity in treatment there. That requires a solution.

The bigger problem that is addressed and I think the traditional communication companies are very concerned about is the difference between tax treatment of communication companies and general business, and that's where you have the huge disparities in rates and where there is a need for Federal solution or Federal guidance that says you can't discriminate, States and localities, you can't discriminate against these communication companies.

And as you said, Mr. Chairman, it's no wonder that consumers are being driven to other solutions, but you eliminate the discrimination that's imposed, and the drive is not going to be there.

Mr. CANNON. Thank you.

Mr. RAUSCHENBERGER. I think we either voluntarily or involuntarily at some point surrender some of our freedom for the security that government offers. We surrender some of our resources for government to spend on common purposes. I think tax systems work best if they're simple, broad-based and low-rate. I would argue the solution that we ultimately need to get to for State taxation is a low rate, fair, broad-based consumption tax, a modernized sales tax across the States where States still have the sovereign right to decide what they want to exempt from taxation and the right to set their own rates.

The solution for telecommunication services, the solution for cable services, the solution for the service that we don't know about yet is simply to define it into the consumption tax base. Make a decision later if you want to exempt it.

I know we're not supposed to talk about that other bill, but really fundamental to solving a lot of these problems is to quit treating telecommunications as if it's something different. It's not Twinkies, it's the expenditure of funds. We ought not to at the State level or the local level charge two to two and a half times a tax penalty simply because we've historically done it.

If you think of the tax system in the United States, you think of a three-legged milk stool is what I tell people. On the one leg, you tax wealth through the property taxes in the United States, mostly in the States. You tax productivity through income taxes. And the third leg of that stool is sales taxes or consumption taxes.

The solution, I think, in the long run that doesn't discriminate between technologies, doesn't pick favorites in companies is to move all of those services into the base of the consumption tax and make public policymakers who want to argue that they shouldn't be in the consumption tax base argue why they ought to be exempted or taxed at a higher rate.

Mr. CANNON. Thank you. I appreciate your time here today. This is an issue that I think is remarkably important. I might point out that State revenues are at an all-time high in part because of the technology boom and in part because of Federal tax cuts. Lots of things are happening here.

This seems to me to be the time States ought to be figuring out to rationalize what they're doing. In part, that ought to include allowing the driving force, which I think has been the Internet, or the network, let's say, more broadly, the opportunity for people to enter with a low threshold to get over, and that ultimately keeping that threshold low for every node on the Internet is probably pretty vital.

This is a complicated area, we recognize it, and we appreciate your input on it, and I suspect we'll have more hearings as we pursue the issue. Again, thank you all for coming. We are now adjourned.

We had a markup scheduled, but because of the briefing on Iraq, we don't have a quorum, and so we are going to adjourn the Committee; not just the hearing, but the full Committee. Thank you all.

[Whereupon, at 5:02 p.m., the Subcommittee was adjourned.]

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