LOCAL GOVERNMENT PERSPECTIVE ON TELECOMMUNICATIONS TAXES*

A Response to Industry's 2004 COST Study

Summer 2006

Executive Summary

During the past decade, the world has witnessed a remarkable transformation in the field of communications. Rapid technological advancements are fundamentally changing the means by which telecommunications services are provided as well as the manner in which people communicate with one another. These advances are increasing the rate of convergence among service providers who in the past were viewed as offering distinct services. In today's marketplace, the line of distinction has been blurred between telephone and Internet services; between wireless, satellite, and cable services; and between long distance and local services. These technological advances are making a huge impact on virtually every industry and, in many respects, are fueling the economic growth and vitality in our nation, states, and local communities.

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As with any business, telecommunications companies need to pay their fair share of taxes. Recognizing the convergence among different types of telecommunications services, local governments generally favor the imposition of taxes on a nondiscriminatory basis, regardless of the technologies used, on competing communications service providers that offer functionally equivalent services. They also favor reforms that will create a level playing field for competition among existing and new service providers. Further, they favor simplifying the administration of state and local taxes on communications services to encourage continued investments and innovations.

While local government groups welcome the opportunity to work with representatives from the telecommunications industry to develop appropriate reforms, this can only be accomplished if government and industry work toward the mutual goal of achieving reforms that are revenue neutral so that state and local governments will have revenues sufficient to provide critical public services.

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It is unfortunate that the telecommunications industry is conducting a multipronged effort to reduce the level of taxes it pays to local governments. In addition to litigation against local governments to contest taxes and fees, the industry is lobbying the federal and state governments to obtain favorable legislation to accomplish the same result.

The industry commissioned a study, published in March 2005 by the Telecommunications Tax Task Force of the Council on State Taxation (COST), titled *2004 State Study and Report on Telecommunications Taxation* (the COST Study).[1] The COST Study summarizes its most important finding as follows:

> The 2004 State Study shows that the average effective rate of state and local transaction taxes is 14.71%, compared to only 6.12% for general businesses nationwide.[2]

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The COST Study contains serious methodological flaws that make it an inappropriate basis for policy decisions, especially the industry's proposals to make widespread changes to local tax structures. The COST Study presents a selective summary of state and local fees and taxes that omits important analytic issues. Moreover, it neglects to highlight parts of the tax system that ***favor*** telecommunications companies compared to other businesses.

The White Paper entitled "Local Government Perspective on Telecommunications Taxes" raises the following issues for consideration.

"Transaction Taxes"

The COST Study's analysis of "transaction taxes" is flawed because it mixes ***taxes***, which apply to a broad range of businesses, with ***user fees***, which are the charges that local governments levy for use of public rights-of-way by private users such as telecommunications companies. The COST Study fails to define "transaction taxes" consistently for telecommunications companies and other businesses. The result of this shortcoming is that the numbers produced by the COST Study indicate much heavier relative burdens on telecommunications companies, compared to other business companies, than are actually the case.

Income Taxes

The 2004 COST Study "does not include income taxes."[3] This glaring omission undermines the usefulness of the COST Study, since it fails to provide an accurate picture of state and local taxation of telecommunications companies. Furthermore, the COST Study fails to disclose that telecommunications companies pay significantly ***lower*** corporate income taxes than other businesses.

Property Taxes

The COST Study's analysis of property taxes shows, by its own numbers, that there is ***no discrimination*** against telecommunications companies in real property taxes. The COST Study finds that telecommunications companies pay

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[1] Companies participating in the 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, and Verizon Wireless.

[2] *2004 State Study and Report on Telecommunications Taxation*, Council on State Taxation, 2005, pp. 3-4.

[3] Ibid., p. 19.

an effective tax rate on real property (i.e., land and buildings) of 2.26 percent, compared to 2.19 percent for other businesses.[4] Similarly, the COST Study shows that the effective tax rate for telecommunications companies on tangible property (e.g., furniture, fixtures, equipment) is 1.85 percent, compared to 1.70 percent for other businesses.[5]

Overall Impact on Local Governments

Because of the flaws of the COST Study with respect to (1) user fees and other fees and (2) income taxes, its estimates of relative tax burdens are incorrect. However, even if taken at face value, the COST Study's data show a tremendous impact on the ability of local governments to provide needed services to their constituents due to lost revenue if the telecommunications industry's recommendations were followed. In 2001, the Telecommunications State and Local Tax Coalition (an industry group) prepared a study suggesting that telecommunications taxes to state and local governments should be reduced by $7 billion. Extrapolating the 2001 suggestion to today, that reduction would have grown to around $8 billion. If governments lost $8 billion in revenue, they would need to shift tax burdens from telecommunications companies to other taxpayers or else cut budgets by an amount equal to the combined salaries of more than 150,000 teachers, police, and firefighters. It would be foolhardy to enact federal laws with the kind of impact that the telecommunications industry seeks, especially if based upon the ***flawed and incomplete information*** provided in the COST Study.

The Effects of Changing Technology

Currently, technological convergence is creating new forms of competition among different types of telecommunications as voice, data, and video are offered over a much broader range of media, including traditional land lines, wireless, cable, satellite, and voice-over-Internet-protocol (VoIP) services. Each of these services is subject to a different set of state and local taxes. In addition, the federal government is showing a disturbing pattern of intervention in state and local revenue policy that has the potential to exacerbate rather than reduce these tax differentials. In this context, ***negotiations*** among state and local government groups and telecommunications companies represent the best way to reduce administrative burdens and promote equitable taxation.

Conclusion

Both the federal and local governments are considering how to levy taxes fairly, without discriminating among companies that provide different forms of the same service. These debates are appropriate, and local government has been a willing partner in attempting to consider potential reforms that would continue to ensure continued growth of technology use and development. However, these goals cannot be achieved if the telecommunications industry continues to produce and circulate among members of Congress findings such as those set forth in 2004 COST Study, which contains serious methodological flaws and omits essential analytic information, and to focus more on obtaining inappropriate advantages than on creating rational tax policy.

[4] Ibid., p. 12.
[5] Ibid.