TAKING THEIR TOLL

Is Excessive Taxation Penalizing Wireless Consumers for Embracing Technology?

BY MARY LOU JAY

If people had to pay a 24 percent sales tax on every new car purchase or a 22 percent tax when they bought a new washing machine, it wouldn't be long before they were angrily demanding that legislators do something about such excessive taxes. What many people don't realize, however, is that they may already be paying such exorbitant rates every month on their wireless service.

The average general sales tax in the U.S. today is around six percent, but the average wireless consumer currently pays about 17 percent in taxes and fees. "Wireless customers are subject to taxes and fees much higher than those imposed on other goods and services," says Scott Mackey, an economist and principal with Kimbell Sherman Ellis in Montpelier, VT. "Wireless companies are not opposed to taxes in principle, but," says Mackey, "they do object to wireless customers being singled out for specific, excessive telecommunications or wireless taxes."

(Editor's Note: To read more by Scott Mackey, see "Roaming With" on page 61)

The combined burden of state, local and federal taxes and fees can be as high as 24.63 percent (in Nebraska). "Between January 2003 and April 2004, wireless taxes grew nine times faster than that of general business," says Jim Schuler, CTIA Assistant Vice President, Policy. "As the industry is reducing prices, because the technology is more efficient and less expensive, state and local governments are raising the cost of service because taxes are going up."

It's ironic, he adds, that wireless customers are paying such high rates. "At 15 to 20 percent, that's close to the level of sin taxes, which are intended to discourage use of a product. But today, mobile communications is a backbone of business. Why would you discourage the use of wireless at a time when communications and mobility are so important?"

Federal tax set to disappear

The imposition of taxes and fees on wireless service starts at the federal level with the Universal Service Fund (USF) fee and the Federal Excise Tax (FET). The industry supports fair and equitable payment and distribution of USF monies, which are primarily intended to provide telecommunications services to poor and rural areas that could not obtain service at market rates.

The FET, however, was another matter. Originally passed in 1898 as a way to fund the Spanish American War, the tax was challenged in court by purchasers of long distance service. Five different U.S. Circuit Court of Appeals ruled in favor of the long distance customers, so finally, the Department of Treasury announced it will no longer claim its right to impose the tax and the Internal Revenue Service will no longer collect it after July 31st of this year. Details have yet to be finalized, but consumers will be able to claim refunds on their tax returns for three years worth of FET payments. CTIA President and Steve Largent praised the actions, saying, "The Spanish-American War ended successfully a long time ago, and now after a rough ride for consumers, so has the battle over the FET. With the FET finally taking its rightful place aside the Spanish-American War in our history books, wireless consumers can now turn their attention and efforts to repealing discriminatory wireless taxes on the state and local level."

Cash cow for state and local governments

State and local governments, however, are reluctant to give up the revenues from wireless taxes. They often try to classify wireless service as a utility, or monopoly, service, subject to much higher tax rates. "States facing budget deficits wanted money quickly, and they felt that they could argue that because wireless was competing with landline service they should be able to tax wireless, too," says Annabelle Canning, assistant general counsel - tax policy at Verizon Wireless. In Pennsylvania, for example, the legislature passed a law in December 2003 that levied a five percent gross receipts tax on wireless services which was in addition to the six percent sales tax on services that consumers were already being charged.

Another tax that wireless consumers pay on the state or local level (or sometimes both) is the 911 tax. But some jurisdictions have appropriated the funds intended for 911 service and used them for other purposes. "We want to make sure that the money

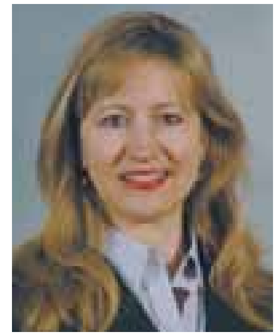
A Taxing Proposition

Taxes and fees pile up on the bills of New York wireless consumers

A New York wireless bill reflects how the consumer sees the current state and local taxation of wireless services

State Sales Tax	4.25%
Local Sales Taxes	4.00%*
MCTD Sales Tax	0.13%*
State Excise Tax	2.50%
MCTD Excise/Surcharge	0.30%*
Local Utility Gross Receipts Tax	1.51%*
State Wireless 911	2.48%
Local Wireless 911	0.62%*
MCTD Surcharge	0.07%*
NY Franchise Tax	0.38%
Federal Excise Tax	3.00%
Federal USF	3.05%
Total	**22.29%**

*Tax applied in selected cities and regions



Annabelle Canning, Assistant General Counsel – Tax Policy at Verizon Wireless

"Local governments are challenged. They are fighting very hard what's coming with convergence and technological change."
Annabelle Canning

Excessive **State** of Wireless Taxes

collected from consumers is used appropriately for public safety and not going into the general fund," says Schuler.

At the local level, taxes on wireless services may be referred to as franchise fees, utility fees, or right-of-way fees. To collect money, local governments often attempt to force a modern technology — wireless service — to comply with tax statutes that belong to another age. One jurisdiction in Missouri is attempting to levy a local business privilege tax on wireless consumers, based on ordinances that deal with trimming trees and putting up telephone poles — something that the wireless industry doesn't need to do.

As wireless services grow and landline services decrease, these jurisdictions are seeing their existing source of revenue — discriminatory taxes on landline companies — go away. "Local governments are challenged," says Canning. "They are fighting very hard what's coming with convergence and technological change. They don't want any change in the regulations, taxes, or fee status that apply to the wireless industry, because under the old utility system they were provided with a lot of money." The governments are responding to changes by trying to impose outdated monopoly-era fee structures on a competitive industry.

"In the past, it was easy for state and local governments to assess these taxes, because there was just one company providing service, and that company didn't have to worry about passing the cost on to the consumer; there were no other providers," adds Neal Osten, federal affairs counsel for the National Conference of State Legislatures (NCSL).

"But deregulation helped to enhance competition and those taxes started to become a problem. As new companies form and new ways of communication become an option, people have choices about telephone service and not paying taxes — with VOIP, for example. What's happened is that taxes have become a competitive disadvantage for landline, wireless, and cable companies that are providing services."

Wireless taxes hurt consumers

Excessive wireless taxes are regressive, hitting the most vulnerable customers the hardest. "Governments can't seem to get rid of the ancient mindset that telecom services are some kind of luxury. But what was deemed a luxury just five years ago is now very common even to working class families," says Pete Sepp, Vice-President of Communications, National Taxpayers Union. "With wireless communication becoming cheaper than landlines to maintain and own under certain circumstances, a telecom consumer is likely to find wireless more attractive than landline from the most basic value standpoint. Governments know this, which is why they're working so hard to find ways to trap wireless communications in some kind of tax web."

The money that people spend on taxes is money they don't use to buy services, which can ultimately slow technological development. "As we are able to sell more services to consumers, those resources are reinvested in newer, high speed, broadband networks and in new innovative services," Canning says. "The impact of these taxes means that we're not going to see the same innovation and wireless broadband deployment and capacity that legislators want to see."

In addition, the job of collecting and remitting taxes to all the local jurisdictions has been burdensome for the wireless carriers. There are approximately 7,000 communities that have some type of wireless taxes, but when you add in special taxing districts (fire, school, library, etc.) that have a separate assessment it means that wireless providers may have to deal with as many as 30,000 distinct jurisdictions when figuring out tax bills.

Fast and easy tax collection

Why has wireless service become a favorite tax target for local jurisdictions?

"Local government's first response to a budget shortfall is usually 'Who can we go to that collects money for us easily and efficiently and that we can turn to with a fair degree of predictability?'," says Dan Piekarczyk, Tax Counsel, T-Mobile. Wireless service, with its growing customer base, offers the potential for increasing revenue, and the administrative work of collecting the tax is easy because there are a limited number of service providers in each area.

Legislators know that many consumers aren't even aware of cell phone taxes. That's because of tax creep — taxes go up in small increments over a period of several years — and because many customers use services such as automatic bill pay, so they don't even look at their cell phone bills.

Finally, the wireless industry itself was behind the times in education and lobbying efforts. "Wireless has not historically been an industry with a big state lobbying presence," Canning notes. "The resources of the companies have been focused on two things: innovation to bring new and better products to consumers; and deployment of infrastructure so as many customers as possible can be reached with the best technology.

"So the wireless industry was caught flat-footed when the industry was no longer flying under the radar; we didn't have the resources in place to gear up to fight these new taxes."

Fighting back

In recent years the wireless industry has taken the initiative to educate wireless consumers about the extent and the effect of the tax burden they are carrying through Web sites (MyWireless.org), television and radio ads and bill stuffers. In addition, some normally competing groups within the telecommunications industry (wireless, wireline and cable companies) have banded together to form CorrecTaxes, a coalition that will work to lower telecommunications taxes. These diverse efforts seem to be paying off.

"On the state and local level there's a great deal of pushback from consumers about increases in wireless taxes," Sepp notes. "I also think

Convergence: Taxation of Consumer Services in a Wireless World

Type of Service	Effective Rate
Telecommunications Services	7 – 34%
Cable Services	5 – 11%
Information Services	0 – 6%
Digital Services (games, music, etc.)	0 – 6%
General Business	6%

(Effective Rate includes Federal, State, and Local Taxes, Fees and Surcharges)

Local governments won't give up easily. In Missouri, where the state legislature capped taxes on wireless at five percent, local governments have challenged the new law in court. The case is now before the Missouri Supreme Court.

"It's a matter of protecting consumers' pocketbooks. They are the ones who are **not getting the advanced services and the cellular coverage they want** because they can't pay everything to everyone. There's a cost to taxing the industry the way that governments are."

Dan Piekarcyzk/ T-Mobile Tax Counsel

that various industry organizations –not just CTIA, but also businesses who depend on stable communications — are starting to rebel against the idea of extraordinarily high tax burdens on these services. They're saying, 'why in the world is the rate on my phone two or three times more than any tax I pay at the cash register?'"

Two cities in Oregon — Springfield and Portland — have tried within the last year to impose specific new taxes on wireless telecommunications services, but these efforts have failed due to consumer opposition. In South Dakota, citizens mobilized after the state imposed a gross receipts tax on the wireless industry, but despite the obtaining of the required number of signatures for a repeal to be placed on the November ballot, the state's Attorney General cited a relatively obscure U.S. Supreme Court decision and ruled against placing the initiative up for a vote. In Maryland, the industry is challenging in court the fees placed on wireless service by Baltimore City and Montgomery County.

In addition, Pennsylvania may be close to repealing its gross receipts tax on wireless service. The measure has passed the House and has gone through the committee in the Senate. Although wireless industry observers are hopeful that it will pass the Senate, the governor has threatened to veto the legislation because he does not want to lose the revenue from this tax.

Virginia sets a good example

The NCSL has studied the issue extensively and has proposed several principles for reforming and reducing excessive and discriminatory communications taxes. "We think the states should really look at way they tax telecommunications," says Osten. "The taxes of all providers of services should be the same; no provider should be tax free or taxed higher than others. Eventually, all taxes should be no higher than general business taxes. Collection and administration of the taxes should be simple, too, similar to what most states are doing with sales taxes right now."

Virginia has recently passed a law some consider a model for telecommunications taxation. Previously, its local jurisdictions had set their own (usually very high) rates on telecommunications services. Under the new bill, however, all such services (wireline, wireless, satellite cable and VOIP) are subject only to the same sales tax rate that is place on other goods and services. Companies will make one payment — to the state — which will then distribute the monies collected back to the various local jurisdictions.

Federal intervention may be required

Although the Virginia statute is one the wireless industry would like to see adopted by many states, that's not likely to happen any time soon, says Osten. "We do have a lot of opposition from local governments who don't want to lose money. They take it as a loss of power and worry that the states won't give them their share of the money on a timely basis."

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The federal government may eventually have to intervene. "The industry does not have the resources to fight this on a state-by-state or local-by-local level, nor would it be efficient to do so," says Piekarczyk. "The answer probably lies in federal legislation that would preempt states and localities from discriminatory taxation of wireless customers and the wireless industry."

Congress might consider legislation similar to the Railroad Revitalization and Regulatory Reform Act of 1976, which protected the railroad industry against discriminatory taxation on the state and local level. The railroad bill, however, was focused narrowly on property taxation; any bill to bring relief to wireless consumers would also have to address the other myriad taxes that local jurisdictions impose. Although there is no legislation on this issue currently before Congress, a bill may be introduced later this year.

However consumers gain relief from excessive taxes on their wireless service, it will be a welcome relief, says Piekarczyk. "It's a matter of protecting consumers' pocketbooks. They are the ones who are not getting the advanced services and the cellular coverage they want because they can't pay everything to everyone. There's a cost to taxing the industry the way that governments are."