

Taxes and Fees on Telecommunications Services in Texas



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| *March 2007*



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The Beacon Hill Institute at Suffolk University

EXECUTIVE SUMMARY

Until recently, telecommunications services consisted of only voice service delivered through a copper wire line directly connected to home or business. The telecommunications provider, generally, was a monopoly. This served all levels of government well, since monopolies facilitated the ability to tax telecommunications at high rates. The taxes served a redistributive function. The revenue generated was used partly to help subsidize services to rural areas, while others were used to fund specific spending purposes such as taxes to fund 911 emergency service lines. However, since the breakup of AT&T, the telecommunications industry has undergone a radical transformation based on a number of innovative platforms that enable new services and greater consumer choice.

Telecommunication services today consist of voice, video, and Internet services offered through wirelines, cables, or wireless networks. Traditionally, each telecommunications service was confined to certain types of delivery modes: television over cable or broadcast antennae, and voice service through wirelines. The tax regime was based on this principal infrastructure. The migration of telecommunications services onto non-traditional platforms—telephone service over Internet protocol (VoIP) for example—has raised new tax issues for both providers and consumers.

Telecommunications taxes are not uniform, and as such, they distort consumer choices. Because taxes and fees differ significantly according to the technology used, consumers have incentive to move from the higher-taxed means of delivery to the lower-taxed platform.

These dramatic changes require new thinking on how best to reform taxes on the telecommunication industry. Many policymakers seek “a level playing field,” in which all telecommunications services would be taxed uniformly. Traditional telecommunications services, such as fixed line telephone services, are more heavily taxed, while newer technologies are taxed lightly, if at all. The goal of tax harmonization across platforms may or may not be optimal. However, applying higher rates from older technologies—such as landline telephones—to the currently lower taxed technologies—such as cell phones and VoIP—would be costly to the consumer and hinder innovation in the market.

Taxes on telecommunications providers in Texas are among the highest in the nation—recent studies place Texas in the top three states nationally. These taxes and fees are passed onto consumers, resulting in higher effective prices. Therefore, a more appropriate reform for Texas would be to reduce the current level of taxation applied to traditional telecommunications services to that of the new technologies that are able to escape much of this taxation.

This study examines the tax burden by type of communication service (i.e. video, voice and Internet) and by provider (i.e. cable, wireline and wireless) for the average subscriber per month. The dataset consists of 12 municipalities in Texas, representative of the different geographic areas in the state. Some of the highlights include:

- Cable video subscribers paid an average of \$5.90 per subscriber per month, or 14.33 percent of an average monthly bill of \$41.17.
- All satellite television subscribers in Texas face a 6.25 percent tax on an average monthly bill of \$50.71 (\$3.17 per month). Currently, state sales tax is the only tax applied to satellite television services.
- Wireline (landline) telephone subscribers paid an average of \$11.12 per month, or 22.30 percent on an average monthly telephone bill. Telephone subscribers in Presidio face the lightest taxation, \$10.13 per month, while those in Dallas are taxed the heaviest, at \$12.24.
- Wireless telephone subscribers paid \$9.49 per month in taxes, an average effective rate of 19.25 percent.
- VoIP customers paid an average monthly tax of \$5.31, or 16.40 percent of an average monthly bill of \$32.40. Since VoIP falls within the definition of telecommunications service, it is subject to many of taxes imposed on other voice service providers.
- Internet customers that access the Internet through wirelines (DSL) or through cable lines (using cable modems) do not pay the same taxes as they do when they use them for telephone or video services respectively. In fact, Internet customers typically do not pay any taxes for access.
- Consumers who subscribe to cable television and wireline and wireless voice services pay, on average, a total monthly tax burden of \$26.51, or 18.89 percent. This equates to an annual tax bill of \$318.

INTRODUCTION

Telecommunication services currently consist of voice, video and Internet services offered through wirelines, cables or wireless networks. Traditionally, these telecommunications services were confined to certain types of delivery modes: television over cable and voice service through wirelines. Regulations regarding the taxation of these services were developed based on this principal infrastructure. The advancement of telecommunications services onto non-traditional platforms has altered the delivery of such services. The transformation is staggering given the lasting domination of the ubiquitous wire-bound telephone. For example, today cell phones are overtaking landline telephones particularly among younger consumers. And voice services can now be delivered over a broadband modem with Voice over Internet Protocol (VoIP), a technology unknown just several years ago. These technological advances create inconsistencies within telecommunications tax regimes.

Because taxes and fees differ significantly according to the technology deployed, (i.e. telephone calls delivered through wireline face different fees than calls made using VoIP) consumers now have incentives to cut their taxes depending on technology.

These dramatic changes require new thinking on how best to reform taxes on the telecommunication industry. Many policymakers seek “a level playing field,” in which all telecommunications services would be taxed uniformly. Traditional telecommunications services, such as fixed line telephone services, are more heavily taxed while newer technologies are taxed more lightly, if at all. The goal of tax harmonization across platforms may or may not be optimal. However, bringing more lightly taxed technologies such as cell phones and VoIP to the higher tax rates found on traditional wireline phones may be costly to the consumer.

A forthcoming study by The Beacon Hill Institute at Suffolk University (BHI) and The Heartland Institute find that the average sales tax on common goods is nearly half the average tax on telecommunications services.¹ In addition, state and local governments in Texas levy some of the highest taxes on telecom providers in the country. These taxes and fees are passed through to consumers—whether explicitly listed on customers’ monthly bills or implicitly embedded in the cost of the services—resulting in higher effective prices for telecommunications services.

The heavy taxation of the telecommunications services originated during a time when the telecommunications industry was a monopoly, and high taxation was the price companies paid to maintain their monopoly status. The revenue generated by some of the taxes was used to help subsidize services to rural areas, while others were used to fund specific spending purposes such as taxes to fund 911 emergency service lines. However, since the industry is now highly competitive, the original arguments supporting these taxes have eroded.

An example that underscores this trend of telecommunications taxes that has outlived its purpose is the federal Universal Service Fund (USF). The fee applies to carriers that supply interstate telecommunications services and its revenues are used to uphold affordable telephone rates in rural areas. USF payments total over \$6 billion a year, but with telecommunication subscriber rates now averaging well over 90 percent of U.S. households, the need for such a fund is questionable.²

This study documents the tax burden shouldered by consumers in Texas. The taxes are organized by the type of communication service (i.e. video, voice and Internet) and by provider (i.e. cable, wireline and wireless) for the average subscriber per month, as well as the average taxes paid by a subscriber who receives three telecommunications services (cable video and wireline and wireless telephone).

The dataset consists of 12 Texas municipalities that are representative of the different geographic areas in the state. The overall tax burdens were determined by identifying the taxes and fees applicable to each service, calculating the dollar value and effective tax rates for each, and summing the value by service and technological platform.

The study discusses the inconsistencies in Texas’ telecommunications taxes, including a comparison between the telecommunications taxes in Texas and the U.S. national averages as well as a comparison between telecommunications taxes and those assessed on other goods and services in Texas. The study explores the origins behind the high taxation of communications services and reforms that state and local governments could pursue to remedy the situation. An extensive description of our methodology follows.

VIDEO SERVICES

Cable Video Services

The majority of municipalities in Texas impose similar taxes and fees on cable video services. In addition to the state sales tax, governments impose an array of user fees, franchise fees and public access fees. Recent cable communications reform regarding cable video franchising in Texas accounts for the uniformity among the taxes and fees in different municipalities.

According to the Telecommunications Act of 1996, providers are required to enter into a franchise agreement with the state-designated franchising authority.³ Although many states are working towards reform, most states currently grant local governments the power to award franchises to cable providers. This explains the variance in the taxes and fees faced by cable customers in the same state.

As of September 1, 2005 the authority to grant franchises in Texas was taken from the local governments, as outlined in the SB 5, and given to the state’s Public Utility Commission (PUCT). Similar to most local franchise agreements, SB 5 requires all cable providers franchised by the state to pay a franchise fee of 5 percent of its gross revenue and a fee in support of public educational and governmental channels (also known as a PEG fee) of 1 percent of its gross revenue.⁴

Centralizing the authority for cable franchise agreements in a state agency eliminates inefficiency and redundancy inherent in franchising at the local level. Statewide franchising streamlines the process by allowing cable providers to deal with one entity, the state, instead of multiple local governments. As a result, competitors can enter the market quicker with the added benefit of meeting one set of franchise requirements rather than complying with requirements that differ across many municipalities.

In addition to the 5 percent franchise fee and 1 percent PEG fee, all cable subscribers in Texas face a \$0.06 Federal Communications Commission (FCC) user fee, a state sales tax assessed at a rate of 6.25 percent, and local sales taxes that range from 1 percent to 2 percent. Therefore, the variation in the average tax per subscriber is fully due to differences in local sales taxes (\$0.42 between the lightest and heaviest taxed subscribers). Dallas, which assesses an additional 1 percent Mass Transit Authority fee is assessed on the cable television services, and Weatherford, which applies an additional 2 percent franchise fee, are exceptions.

TABLE 1. MONTHLY TAXES AND RATES ON CABLE VIDEO SERVICES

City	Tax (\$)	Tax Rate (%)
Houston	5.52	13.40
San Antonio	5.56	13.52
Austin	5.62	13.65
Columbus	5.72	13.90
Abilene	5.93	14.40
Brownsville	5.93	14.40
Canyon	5.93	14.40
Port Arthur	5.93	14.40

City	Tax (\$)	Tax Rate (%)
Presidio	5.93	14.40
Wichita Falls	5.93	14.40
Dallas	6.27	15.22
Weatherford	6.54	15.90
Average	\$5.90	14.33%

In contrast, consumers face substantial variation in the total monthly taxes and fees in states where local governments negotiate franchise agreements. For example, cable subscribers in St. Paul, Minnesota pay more than twice the amount (\$9.82) in monthly taxes and fees than cable subscribers pay in Minneapolis, Minnesota (\$4.22).⁵

Table 1 presents the data for the average monthly taxes paid by cable video subscribers in the 12 municipalities. The average tax paid in these municipalities is \$5.90 per subscriber, or 14.33 percent. Houston imposes the lightest tax burden on their subscribers, taking \$5.52 per month, for an effective tax rate of 13.40 percent, while Weatherford imposes a heavier tax burden of \$6.54, or 15.90 percent. The variation from city to city is primarily caused by the differences in local sales taxes: Houston and San Antonio subscribers pay the lowest local sales taxes, 1.00 percent and 1.12 percent respectively.

Wireless Video Services (Satellite Television)

All cable television services in Texas are subject to the state sales tax. According to Texas tax code, “cable television service” means the distribution of video programming with or without use of wires to subscribers. Thus the state sales tax of 6.25 percent is imposed on video services through satellite providers, such as DirecTV. Although federal law preempts the collection of local sales tax on direct-to-home satellite television service, it does not affect the application of the state sales tax.⁶

In comparison, satellite video services are not taxed nearly as heavy as cable television services. The state sales tax is the only tax applied to satellite television services in Texas. As a result, satellite television subscribers in Texas face only the 6.25 percent state sales tax, or (\$3.17 per month based on an average monthly bill of \$50.71).

Although satellite subscribers only pay an average effective rate of 6.25 percent today, a number of state legislatures are considering a satellite television tax. If legislatures are successful in enacting new taxes, satellite subscribers would pay higher tax rates.

VOICE SERVICES

Telephone services can be provided by wirelines (traditional dial-up), cables (using VoIP received over a cable modem) or wireless (cellular devices). Although the telephone services offered are primarily the same, regardless of the provider, the taxes differ as well as the way the taxes apply to an average customer’s bill. Prominent taxes that apply to voice services are state and local sales taxes, 911 Fees and Surcharges, the Telecommunications Infrastructure Fund fee (TIF), and Federal and State Universal Service fees.

QuickFact:

The state sales tax is the only tax applied to satellite television services in Texas. Satellite television subscribers in Texas face only the 6.25 percent state sales tax, or \$3.17 per month based on an average monthly bill of \$50.71.

Wireline

Telephone service provided through a wireline is considered both a telecommunications service and a public utility; as a result, telephone carriers pay all the taxes and fees that apply to telecommunications services as well as many of those that apply to public utility companies. In addition to those mentioned above, telephone companies are typically assessed a PUC Gross Receipts fee and a Municipal Rights of Way fee. Furthermore, the sales tax base is comprised of the average monthly bill plus some of the taxes and fees that apply to telephone services; including Federal and State Universal Service, Public Utility Gross Receipts, Telecommunications Infrastructure Fund, and Municipal Right of Way fees. This increases the sales tax base by an average of \$4.31.

Table 2 shows the taxes paid per month by the average wireline telephone subscriber, and the effective rate, on an average monthly bill of \$49.87. The average for the 12 municipalities is \$11.12 per month, or 22.30 percent of the average monthly telephone bill. Telephone subscribers in Presidio pay the lowest wireline taxes, \$10.13 per month, while those in Dallas are taxed the heaviest, \$12.24.

TABLE 2. MONTHLY TAXES AND RATES PAID ON WIRELINE VOICE SERVICES

City	Tax (\$)	Tax Rate (%)
Presidio	10.13	20.32
Brownsville	10.56	21.18
San Antonio	10.58	21.22
Port Arthur	10.73	21.51
Abilene	10.78	21.62
Canyon	11.02	22.10
Houston	11.03	22.13
Columbus	11.18	22.42
Wichita Falls	11.24	22.53
Austin	11.93	23.93
Weatherford	12.03	24.13
Dallas	12.24	24.55
Average	\$11.12	22.30%

Although there is not a significant difference among intrastate telephone tax rates, Table 2 illustrates that there is more variation in the average monthly tax paid by telephone subscribers than that paid by cable video customers. This is partly due to Texas's cable video statewide franchise structure, described above. But it is also attributed to the telephone taxes and fees assessed by local governments, such as municipal Right of Way (ROW) fees and local 911 fees. For example, the local government of Presidio only imposes a \$0.27 ROW fee per access line, while Austin and Dallas levy \$1.22 and \$1.45 respectively.

Wireless

The major taxes and fees applied to wireless telephone services are similar, but not quite the same, as those that apply to wireline telephone services. Like wireline providers, wireless carriers are required to pay the Federal and State Universal Service Fund fees, state and local sales taxes, an Equalization Surcharge, and the TIF fee. In substitution of the state 911 emergency service fee, wireless providers pay a specific 911 wireless emergency service fee, administered at the same rate. Wireless carriers are exempt from the Municipal Rights of Way fee (since they do not obstruct the public’s right of way) as well as taxes and fees that apply to public utilities.

Although wireless providers are required to pay many of the same taxes and fees as wireline carriers, they are typically administered differently. Since most wireless providers offer local and long distance service for one bundled price, taxes that only apply to interstate or intra-state telephone services for wireline customers, apply to the entire bill for wireless telephone subscribers. Therefore, Texas customers pay state and local sales tax, and Federal and State Universal Service Fund Fees on their entire wireless telephone bill. As a result, wireless customers pay a greater amount in these specific taxes and fees than wireline customers.

Table 3 shows total monthly taxes paid by the average wireless telephone subscriber. The average tax per month paid by the typical wireless customer is \$9.49, or 19.25 percent. Telephone subscribers in Austin pay the lowest wireline taxes, \$8.85 per month, while those in Presidio are taxed the heaviest, at \$9.72.

TABLE 3. MONTHLY TAXES AND RATES PAID ON WIRELESS TELEPHONE SERVICES

City	Tax (\$)	Tax Rate (%)
Austin	8.85	17.96
Houston	9.18	18.63
San Antonio	9.25	18.76
Columbus	9.45	19.17
Port Arthur	9.45	19.17
Weatherford	9.45	19.17
Dallas	9.68	19.64
Wichita Falls	9.69	19.66
Abilene	9.72	19.71
Brownsville	9.72	19.71
Canyon	9.72	19.71
Presidio	9.72	19.71
Average	\$9.49	19.25%

QuickFact:

The average tax per month paid by the typical wireless customer is \$9.49, or 19.25 percent. Telephone subscribers in Austin pay the lowest wireline taxes, \$8.85 per month, while those in Presidio are taxed the heaviest, at \$9.72.

Voice over Internet Protocol (VoIP)

Since it falls within the definition of telecommunications service, VoIP is subject to many of taxes imposed on other voice service providers such as state and local sales taxes, the Telecommunications Infrastructure Fund (TIF) fee, and the Federal Universal Service Fund. However, like wireless carriers, VoIP providers offer unlimited local and long-distance calls for a single monthly charge, and do not distinguish between intrastate and interstate calls. Therefore, similar to wireless service, VoIP subscribers pay taxes and fees on their entire monthly bill (rather than on just one portion of the bill).

Table 4 illustrates the total monthly taxes and fees paid by VoIP customers, where the average monthly tax is \$5.31, or 16.40 percent of an average monthly bill of \$32.40. The disparity in tax rates across the municipalities is due to the variance in local sales tax.

TABLE 4. MONTHLY TAXES AND RATES PAID ON VOICE OVER INTERNET PROTOCOL SERVICES

City	Tax (\$)	Tax Rate (%)
Houston	5.08	15.69
San Antonio	5.13	15.82
Austin	5.17	15.96
Columbus	5.26	16.23
Port Arthur	5.26	16.23
Weatherford	5.26	16.23
Dallas	5.43	16.76
Abilene	5.43	16.77
Brownsville	5.43	16.77
Canyon	5.43	16.77
Presidio	5.43	16.77
Wichita Falls	5.43	16.77
Average	\$5.31	16.40%

Although the current average monthly tax on VoIP services is \$5.31, this is likely to change in the near future for two reasons. First, in May 2005, the FCC adopted rules requiring providers of VoIP services to supply 911 emergency calling abilities to their subscribers as a mandatory feature of the service.⁷ Even though providers have adapted to the new requirement, most carriers have not yet enforced a 911 fee on their customers. An additional 911 fee on VoIP services would likely be equivalent to the 911 fee on other telephone services, a \$0.50 charge per line per month. Second, VoIP providers can anticipate that they will soon be subject to the same municipal ROW fees faced by wireline voice providers. Traditionally, ROW fees were only levied on telephone services provided by companies certified by the PUC. However, a provision in Chapter 66, Texas Utility Code, imposes municipal ROW fees on all voice service providers that are at “least in part of the public right of way, without regard to the delivery technology, including Internet protocol technology.” Although wireless voice services are specifically excluded, the clause clearly could be interpreted to include VoIP carriers.⁸

INTERNET SERVICES

Internet customers have the choice of accessing the Internet through a number of ways; through wirelines (either dial-up or Digital Subscriber Line, DSL), through cable lines (using cable modems) and through wireless networks (such as Wi-Fi). However, Internet access subscribers do not pay the same taxes when they use wirelines or cables to access Internet as they do when they use them for telephone or video services respectively. Cable broadband customers do not currently pay franchise fees or any other transaction taxes that are assessed on cable television providers. Similarly, DSL subscribers do not pay 911 taxes or public utility taxes that are imposed on wireline telephone customers. In fact, Internet customers typically do not pay any taxes at all on Internet access.

Policies regarding the application of sales taxes and fees on Internet access are enforced inconsistently across states and municipalities. With the exception of eight states that imposed taxes on Internet access prior to November 2005 (Texas not being one of them), state and local governments are prohibited from taxing Internet service as dictated by the Internet Tax Freedom Act, passed in 2004.⁹

TOTAL TAXES ON COMMUNICATION SERVICES

Table 5 combines the monthly taxes an average communications customer pays who subscribes to cable television and wireline and wireless telephone services. Consumers who subscribe to all three services have an estimated total average monthly bill of \$140.34, consisting of \$41.17 for cable services, \$49.87 and \$49.30 for wireline and wireless telephone services respectively.

The total tax burden ranges from \$25.40 (18.10%) in San Antonio to a high of \$28.19 (20.09%) in Dallas.

TABLE 5. MONTHLY TAXES PAID ON CABLE VIDEO, WIRELINE AND WIRELESS VOICE SERVICES

City	Tax (\$)	Tax Rate (%)
San Antonio	25.40	18.10
Houston	25.73	18.34
Presidio	25.78	18.37
Port Arthur	26.10	18.60
Brownsville	26.21	18.68
Columbus	26.35	18.78
Austin	26.41	18.82
Abilene	26.43	18.83
Canyon	26.66	19.00
Wichita Falls	26.86	19.14
Weatherford	28.03	19.97
Dallas	28.19	20.09
Average	\$26.51	18.89%

Table 6 presents descriptive statistics of the taxes applied in all 12 municipalities in our survey. Other than Internet service (which is not included in the table because it is not taxed in Texas), cable video services, on average, were taxed more lightly than the other two services, wireline and wireless telephone services. Cable video services were taxed at a rate of \$5.90, more than \$5.00 lower than the wireline rate of \$11.12.

TABLE 6. VARIABILITY OF TAXES PAID ON CABLE, WIRELINE AND WIRELESS SERVICES (\$)

	Voice			Video	
	Wireline	Wireless	VOIP	Cable	Satellite
Low	10.13	8.85	6.63	5.52	3.17
High	12.24	9.72	6.69	6.27	3.17
Average	11.12	9.49	6.56	5.90	3.17
Average Rate (%)	22.30	19.25	20.26	14.33	6.25

FURTHER DISCUSSION

Texas Telecommunications Taxes Relative to the National Average

Table 7 represents the average monthly rates on communications in Texas as compared with the national averages. The Texas rates are a great deal higher, especially in the case of Wireline voice services. Texas residents pay an average of 22.30 percent a month while the rest of the country pays an average of 17.23 percent. This is largely due to the additional state and local taxes, such as a 5 percent state Universal Service Fund fee and a Telecommunications Infrastructure Fund fee of 1.25 percent, levies on wireline telephone providers. Although, many other states do assess fees on wireline voice carriers, they are typically not as high as those in Texas. Texas residents pay 7.4 percent more in wireless taxes than do consumers in other states for similar reasons. Consumers of cable video services in Texas pay only a little over 2.5 percent in taxes than consumers in other states. This smaller discrepancy in the tax rates for video services highlights the progress Texas has made in video franchise fee reform, and the need for reform in voice services.

TABLE 7. COMMUNICATIONS TAX RATES IN TEXAS RELATIVE TO THE NATIONAL AVERAGE

	Texas (%)	U.S. Average (%)
Wireline Voice	22.30	17.23
Wireless Voice	19.25	11.90
Cable Video	14.33	11.69

Texas Telecommunications Relative to Taxes on Other Goods

Table 8 compares telecom taxes with levies on other goods and services in Texas. All voice service tax rates are approximately double the state and local sales and use tax rate of 8.25

percent. The tax rates for the telecommunications covered in this report (wireline, wireless, VOIP, and cable video) with the exception of satellite video services, are, on average, higher than the taxes on fireworks (10.25%) and mixed alcoholic beverages (14.00%). In fact, cigarettes are the only item taxed higher than telecommunications, which weigh in at a hefty 35.60 percent.

TABLE 8. TAXES ON TELECOMMUNICATIONS AND OTHER GOODS AND SERVICES

Good or Service	Rate (%)
Wireline	22.30
Wireless	19.25
VOIP	16.40
Cable	14.33
Satellite	6.25
Sales & Use	8.25
Hotel	6.00
Motor Vehicle	6.25
Fireworks	10.25
Mixed Beverages	14.00
Cigarettes	35.60

Why Communications Taxes are High and Discriminatory

Why are telecommunications services, which are essential since they improve the quality of life, routinely taxed at several times the rate of general businesses? There are three reasons; the first is historical, the second is political, and the third is bureaucratic.

The heavy taxation of communications services is a legacy of a time when the industry was dominated by government-regulated monopolies. Telephone and cable companies could pass on taxes to customers without concern that these high taxes would drive customers to search for lower prices from competitors. There simply were no competitors and thus no alternatives for consumers.

Today, new technologies and regulatory changes allow cable, wireline and wireless companies to compete in each others' traditional core businesses; and for new competitors to enter the market that are not subject to the same cost and tax burdens as the tradition competitors (Vonage). In this newly competitive marketplace, taxing wireline telephone calls at a rate different from wireless or VoIP calls will result in people moving from the higher-taxed technology platform to the less-taxed platform. Competition and choice mean service providers can pass taxes through to their customers only if those taxes are even with those paid by competitors, otherwise they stand to lose customers.

Politics plays its part. While the technological hurdles that once limited competition in telecommunications services have been overcome, policymakers have not reduced the high tax rates that are a legacy of the monopoly era. Telephone and cable companies remain easy targets for taxation because nearly everyone is a customer and because the companies bill

their customers every month. Unfortunately, governments at all levels have succumbed to the temptation to use telecom tax revenues to fund programs and activities unrelated to telecommunications. These taxes and fees have evolved into sources of revenue for the general fund and support programs, benefiting small but highly leveraged interest groups.

Bureaucracy is the third reason for high telecom taxes. Enormous federal and state bureaucracies depend on telecommunications taxes. As theory and practice suggests, the constituencies with stakes in bureaucracies are well organized and opposed to change. One example is the federal Universal Service Fund (USF). Since 1998, the Universal Service Fund rate has tripled and annual dispersals have grown nearly 50 percent, from \$5 to \$7 billion.

Consequences of High Taxes

What are the consequences? Imposing taxes on telecommunications services that are two and three times higher than those imposed on other goods and services:

1. Forms an unjustifiable burden on low and middle income consumers;
2. Creates a variation in taxes from city to city and state to state, placing a high compliance burden on communications companies;
3. Distorts consumer choices and investment decisions; and
4. Hampers economic growth and global competitiveness.

Policymakers at the federal, state, and local levels all have opportunities to introduce or support legislation to reduce taxes on communications services and make them more uniform.

Opportunities for Reform

Federal preemption is justified for two reasons. First, telecommunications has clearly become a national and even global form of commerce, and state and local taxes and fees have become barriers to interstate commerce. Second, technological change means a growing number of competitors in the communications marketplace do not maintain a local presence in their customers' communities. Whereas wireline telephone companies require a central office switch while cable companies operate satellite operations, a growing number of VoIP and online video services have no physical "nexus" to their customers and consequently cannot be taxed by state or local governments.

At least six states, including Texas, have streamlined the process for new video providers allowing them to apply directly to the state. Although the specifics differ among these states, the new reforms include the following:

- the application of franchise fees to cover only right-of-way costs, and
- a redefinition of "video revenues" so as to limit them only to the franchise fee formula.

State governments can also address tax burdens that fall disproportionately on consumers of telecommunications services. There are at least two examples of this in Texas. One is the Telecommunications Infrastructure Fund fee. Created to fund telecommunications infrastructure build out in schools and hospitals, the revenue from this fee now goes into general revenue. If not dealt with now, it could be like the federal excise tax which lasted more than a hundred years after it was first created to help fund the Spanish American War. Another example is the tax-on-a-tax, or cascading nature of the sales tax in Texas. It is levied on a variety of other taxes and fees. These two taxes cost Texas consumers approximately \$300 million per year and distort economic decisions by consumers and providers. They should be repealed.

Local governments can act unilaterally to repeal current discriminatory taxes on communications services and remove regulatory obstacles to new entrants. Local governments should also avoid competing with private companies to provide commercial communications services. This has been a popular course of action, especially for municipalities that already provide public electric or water services.

Contrary to what some advocates and consultants say, telecommunications services such as broadband are not “just like sewers” or other traditional public utilities. The telecommunications industry is fiercely competitive thanks to rapidly changing technology. Cities hoping to get on the broadband bandwagon should review policies that are discouraging investment in affordable broadband before gambling their taxpayers’ dollars on municipal systems.

Public officials often cite the high price of service as one reason for publicly-provided municipal cable or broadband systems. However they fail to recognize the contributions that discriminatory taxes make to those high prices.

CONCLUSION

The data from this survey demonstrates that taxes vary according to the type of technology. The taxation of video services provides a clear illustration: video services offered through cable are taxed at an average rate of 14.33 percent while the same services offered wirelessly (satellite television) are barely taxed at all.

Furthermore, the telecommunications industry shows no signs of slowing down, specifically in Texas. Recently, Texas authorized the use of broadband over powerlines, BPL, another new emerging technology. BPL delivers Internet services similar to cable and DSL but over the electric grid. An electricity utility may lease its lines to operate a BPL service or system, and consumers will be able to access the Internet by simply plugging a device into an existing electric outlet.¹⁰

Although technological advances such as BPL potentially introduce competition in the telecommunications market, they, like other technologies, also introduce significant taxing inconsistencies.

As new technologies enter the telecomm market, traditional means of services will continue to face pricing pressures that inevitably result from tax discrimination. Consumers will base their choices on less costly (or lower taxed) services. Higher taxes on landline telephones for example, pose a disincentive to consumers. At the same time, state and local governments face significant tax revenue losses as a result of this patchwork of taxation. While public officials may be tempted to harmonize taxes by raising them on the newer technologies, genuine tax reform should be geared towards enhancing consumer welfare and encouraging technological innovation by reducing telecommunications taxes on higher taxed services and technologies. ★

METHODOLOGY

BHI obtained all of the information regarding local, state, and federal taxes and fees imposed on telecommunications services in dataset that consists of 12 municipalities in Texas. The finished product is a series of tables that display the taxes and fees imposed on different telecom and cable services in dollar and percentage terms for an average customer.

Taxes and Fees for Cable Video Services

BHI identified state and local sales taxes, franchise fees, user fees, and public access fees as the most prominent taxes and fees imposed on cable companies offering video service. We obtained these taxes and fees (the dollar amount paid by the cable franchise) by reviewing Chapter 66, Texas Utility Code (SB 5) and contacting local officials. Documentation for all sources is available at BHI.

FCC User Fee

Cable regulatory/user fees are determined by the FCC and are imposed on all cable television systems. The FCC figure of \$0.79 per subscriber for fiscal year 2005 was used for all municipalities. The \$0.79 figure is divided by 12 months to attain the monthly value of \$0.06 tax per subscriber.¹¹

Franchise Fee

Cable franchise fees are paid by the cable company to the state government in exchange for the use of the public's right of way. The franchise fee is 5 percent of the gross revenue from providing cable services.

PEG (Public Education and Government)

The state also requires cable operating systems to pay a PEG fee of 1 percent per subscriber. The fee is used for the support of public, educational and governmental channels or to support an institutional network.

Free Connections and Monthly Service

Cable system providers are also obligated to provide, free of charge or at a discounted rate, basic monthly service to municipal buildings, including public schools, libraries, and other public buildings. The cost of providing this monthly service is not included in the tables presented here tables due to the difficulty of computing its value. Nonetheless it is an additional cost to cable companies. Although it is not transparent and identifiable as a separate line item on a monthly bill, the cost is most likely passed onto the consumer.

Taxes and Fees for Wireline and Cable Telephone Services

Information about taxes and fees paid by fixed-line telephone and cable companies to state and local governments were based on telephone interviews with state and local officials. The websites of the Public Utility Commission of Texas and the Office of Public Utility Counsel were also used.

Due to the difficulty in determining the specific amount, if any, passed on to consumers, corporate taxes were not included in this study. Furthermore, many factors effect revenue collected from corporate taxes which depending on various factors, change significantly from year to year.

The treatment of the taxes applied to wireline voice services is described below.

Federal Universal Service

The only Federal tax applied to telephone services is the Federal Universal Service Fee. The Federal Universal Service Fund was enacted to uphold affordable telecommunication service rates. All providers of telecommunication services are required to contribute a percentage of their interstate and end user revenues to the Federal Universal Service fund. The fee changes quarterly, and is increased and decreased according to the needs of the programs funded by the fee. We applied a 1.00 percent tax on all fixed line voice services.

State and Local Sales Tax

Telephone services, offered by wireline and cable carriers, between locations in Texas are subject to state and local sales tax, whereas interstate calls are only subject to state sales tax. We applied the state sales tax of 6.25 percent to the total average monthly bill for telephone service offered by these two types of carries, and applied the local sales tax of each municipality to the intrastate portion of an average monthly bill.

Public Utility Gross Receipts

Funds generated from this fee are used to fund the Public Utility Commission of Texas and the Office of Public Utility Counsel. The fee is assessed on all public utilities, which includes all telephone companies, at a rate of one-sixth of 1 percent of their gross receipts.¹²

911 Emergency Service Fee and 911 Equalization Surcharge

The Texas Legislature made major changes to the state's 9-1-1 emergency communications laws. Now all telephone services, regardless of the provider, face some form of a 911 fee. The fees are imposed to help fund the cost of providing emergency services. Typically, revenue generated from the tax is used to offset the maintenance, system upgrades, and the salaries of dispatchers paid by the state, county, and/or city in order to supply 911 emergency services. Texas also permits county and/or local governments to additionally levy a 911 tax on cable/fixed line voice providers.

Texas levies a 911 emergency service fee at a rate of \$.50 per month for each access line. Texas also imposes a 911 equalization surcharge on telephone providers. After the major changes were made to the state's 911 laws, the poison control surcharge was combined with the equalization surcharge to simplify administrative costs. Therefore, 50 percent of the equalization surcharge revenue is used to fund regional poison control centers in Texas. The surcharge is now imposed, at a rate of 1 percent, on a customer's intrastate long-distance telephone service. Since the FCC only breaks the average monthly bill down to local and long distance service we applied the surcharge to the long distance portion of the bill.

Telecommunications Infrastructure Fund (TIF)

Texas levies a 1.25 percent Telecommunications Infrastructure Fund (TIF) assessment on all telecommunications services. The fund was established to make sure that all citizens have access to sophisticated telecom services. The quarterly TIF assessment is calculated on receipts from telecommunications services.

Texas Universal Service Fund Surcharge (TUSF)

Since 1987, the TUSF is assessed on all Texas telecommunications services. The majority of the funds collected are used to provide basic telephone service at affordable rates in Texas, while the rest supports voice services to low-income and disabled Texans. Telecommunications providers are allowed to pass the costs of the TUSF through to residential and business customers on their monthly bills. As of September 1, 2004, the assessment rate changed from 3.60 percent of all taxable receipts to 5.65 percent of intrastate telecommunications services receipts.

Municipal Right of Way Fee

Municipal Right of Way Fees are levied on telephone providers for a similar reason franchise fees are imposed on cable companies: for the use of the public's right of way. They are paid by the telephone company to local governments and vary by city. Since March 1, 2000, all franchise fees in Texas are required to be based on a fee-per-access line method.¹³

Taxes and Fees for Wireless Telephone Services

The 2004 study of state and local taxes imposed on the wireless telecommunications industry by Scott Mackey provided a source of reference for the data for wireless telephone services.¹⁴ In order to confirm or collect the correct data, we again contacted state and local government officials who either provided us with the correct information or suggested other sources of information.

As mentioned earlier, wireless telephone providers pay similar, but not the same, taxes and fees as wireline carriers. They are required to pay the Federal and State Universal Service Fund fees, state and local sales taxes, an Equalization Surcharge, and the TIF fee described above. In substitution of the state 911 emergency service fee, wireless providers pay a specific 911 wireless emergency service fee, administered at the same rate. We applied all of these taxes to the entire average monthly wireless bill. We do not include the radio spectrum license payments wireless companies are required to pay the federal government because they are sunk costs that are not passed on to customers.

Taxes and Fees for VoIP Services

The information regarding the treatment of VoIP services was collected from the Texas Comptroller of Accounts. The comptroller's office clarified the fact that VoIP services are categorized as telecommunications services. Accordingly, state and local sales taxes, a TIF assessment and the Federal Universal Service Fund Fee (6.62% rate) are imposed on VoIP providers.

Taxes and Fees for High-Speed Data Services

The Internet Tax Freedom Act of 1998—renewed in 2004—prohibits state and local governments from imposing new taxes on the Internet through 2007.¹⁵ Taxes prohibited by the bill include all taxation on internet access services provided to end users, including sales and excise taxes. However, the bill allows Internet taxes in those states that “imposed and actually enforced prior to October 1, 1998,” granted that the provider of Internet services “had a reasonable opportunity to know... that such agency has interpreted and applied such tax to Internet access services.”

Subscribers

Most public authorities were unable to provide subscriber numbers for their municipality, deferring to service providers as the source for such information. However, The National Cable Television Association (NCTA) provides our estimates for total basic cable and residential cable telephone subscribers as well as satellite television customers for the United States. Wireless telephone subscriber numbers came from the Wireless Association (CTIA). The FCC also produces telephone subscriber penetration rates for each state. These estimates were used to impute values for the number of subscribers for each city.

The U.S. Census Bureau estimates for population of the United States, the state and city were used to distribute the NCTA, CTIA and FCC national and state subscriber figures for each city. First, we calculated the ratio of the population of each state to the total U.S. population and the ratio of the population to each city to total state population. Next, we applied these ratios for each city to the FCC estimates of the number of subscribers in each state.

For example, the population ratio of Dallas to Texas is 5.31 percent ($1,213,825 / 22,859,968 = 5.31\%$). The FCC estimates that Texas has 1,529,564 high-speed Internet data lines (ASDL and SDSL), and therefore we estimate Dallas to have 81,217 DSL subscribers ($1,529,564 \times 5.31\% = 81,217$). A similar process was applied to all cities using the FCC estimates for cable broadband subscribers.

The FCC estimates the percentage of households with a fixed line telephone for each state. We simply apply this percentage rate for the respective state to the population estimates for each city. The FCC estimates that 91.1 percent of households in Texas have a fixed line telephone, and we estimate that Dallas has 393,521 telephone subscribers.

A similar approach was used to impute the NCTA estimate of total cable video subscribers in the United States to the cities. First, the ratio of the population for the state to the U.S. population was used to distribute the estimate of national cable subscribers to Texas. Then, the ratio of the city population to the state population was used to distribute our estimate of the number of cable subscribers in Texas to the respective cities. Using Dallas as an example, the ratio of Texas' population to the U.S. population is 7.71 percent ($22,859,968 / 296,410,404 = 7.71\%$) and applying this ratio to the total cable subscribers reported by NCTA provides an estimate of 5,059,249 cables subscribers in Texas ($65,600,000 \times 7.71\% = 5,059,249$). We apply the ratio of Dallas' population to the U.S.' population, or 5.30 percent, to provide us with our estimate of the total number of cable subscribers in Dallas, or 268,637 ($7,984,388 \times 5.30\% = 268,637$).

Average Bill

We use estimates of an average monthly bill in the United States for the telecommunications services included in the study. The average bill is applied to all cities. Clearly some cities (generally where higher income families reside) have higher average monthly bills than others. Consequently, the effective tax rates or the tax per subscriber calculations may result in similar figures across several cities.

The average bill for cable video services (\$41.17) comes from the National Cable and Telecommunications Association (NCTA) and represents a 2006 estimate of the average monthly price for expanded basic programming packages.¹⁶

The FCC supplied average bill figures for fixed-line voice services (\$49.87) from the FCC and from the CTIA for wireless voice services. The VoIP average monthly bill figure came from Microeconomic Consulting Research Associates.¹⁷

The average bill for cable (\$41) and telephone (\$32) high-speed internet access is from a report by the Pew Internet and American Life Project and represents a 2006 estimate of the average monthly price for these services.¹⁸

Calculations

The computations of the effective tax rate, tax per subscriber and annual tax revenue for each service (video, voice and data) and tax depended on the data source and level of detail. The calculation method described below was employed for all three means of service delivery: cable, fixed line and wireless.

Tax Rate

If the percentage tax rate is available, we then multiply the average bill by the percentage rate to obtain the monthly tax per subscriber. For example, the franchise fee for all the municipalities in Texas was computed: $\$41.17 \times 5\% = \2.06 tax per subscriber. The annual tax revenue is calculated by multiplying the tax per subscriber figure by the number of subscribers and 12 months.

The percentage rate for some taxes (franchise fees in particular) applies to the firm's gross revenues and others apply to the customer's bill. In the absence of the any figure for gross revenues, we compute the annual revenue by using the average monthly bill as a proxy: multiplying the monthly bill by the tax rate and multiplying the result by the number of subscribers.

Taxpayer Subscriber

If the monthly dollar amount paid per subscriber is available then we input it directly into the tax per subscriber column. The calculations for the effective tax rate and the annual tax revenue remain the same as in the previous two paragraphs.

ENDNOTES

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About this Report

Until recently, telecommunications services consisted of only voice service delivered through a copper wire line directly connected to a home or business. The telecommunications provider, for example, the telephone company, was a monopoly. This served all levels of government well since monopolies facilitated the ability to tax telecommunications at high rates. The taxes served a redistributive function. The revenue generated was used partly to help subsidize services to rural areas, while others were used to fund specific spending purposes such as taxes to fund 911 emergency service lines. However, since the breakup of AT&T, the telecommunications industry has undergone a radical transformation based on a number of innovative platforms that enable new services and greater consumer choice.

This study documents the tax burden shouldered by consumers in Texas. The taxes are organized by the type of communication service (i.e. video, voice, and internet) and by provider (i.e. cable, wireline, and wireless) for the average subscriber per month, as well as the average taxes paid by a subscriber who receives three telecommunications services (cable video, wireline, and wireless telephone).

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The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute guided by the core principles of individual liberty, personal responsibility, private property rights, free markets, and limited government.

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