

Bringing Telecommunications Regulation into the 21st Century

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Recommendations

- Remove the authority of the PUCT to regulate rates, tariffs, terms, and conditions of service.
- Expand competition in rural markets.
- Promote healthy competition within the telecommunications industry with a uniform method for determining property values.
- Eliminate taxes on production goods that are used to deliver consumer telecommunications service.
- Eliminate the “tax on a tax” application of the sales tax to taxes and fees on a telephone bill.
- Reduce the Utility Gross Receipts Assessment tax to produce only enough money to pay for regulatory programs at the PUC.
- Reduce the 9-1-1 charge on telephone bills to provide only the revenue necessary to maintain and support the infrastructure.

Introduction

Texas generally has been one step ahead of the rest of the country in passing major telecom reform legislation, with reforms in both 1995 and 2005.

Thanks to the most recent legislation—SB 5—local telephone service for more than 15 million Texans was largely deregulated as of January 1, 2006. This was a major step forward in reducing costs and bringing new technologies and services to millions of Texans. Yet there is still more that can be done to improve the regulatory structure in today’s modern technology marketplace.

Texas has a very competitive telecommunications market. In a competitive marketplace, if a company provides unreasonable rates, they will be forced out of the market by their competitors offering lower prices. The rationale for price regulation of this industry is outdated and based on the old monopoly model that is no longer in existence.

Telecommunications services have, quite simply, surpassed their regulations. Wirelines (or land-lines) are fading away and making room for new technologies such as VoIP, wireless, CMRS, and satellite technology. In a system where many of the regulations revolve around wireline carriers, the regulations only serve to slow down competition, innovation and investment.

A similar complaint can be made against the unlevel playing field that exists in terms of taxes and fees. Different providers often utilize

technologies that are subject to differing levels of fees and taxes. Discriminatory taxes based on technology negatively impact decisions made by both producers and consumers and therefore promote inefficiency in the market.

Consumers in Texas also face some of the highest telecommunications taxes in the U.S. While significant progress has been made recently through the repeal of the Telecommunications Infrastructure Fee (TIF tax) and a reduction in Universal Service Fund fees, much remains to be done.

The solution for Texas is to “clean up” the current statutes to remove the monopolistic era relic regulations, make sure that the test for a competitive market is reflective of the advancing technological marketplace, and reduce or eliminate burdensome taxes and fees that only serve to increase prices to consumers.

Improving Telecommunications Regulation

Even though more than 15 million Texans live in areas where telephone service has been significantly deregulated, there are still price controls in effect in those areas. For instance, companies must apply rates evenly across a deregulated market, consistent with pricing flexibility that was available on August 31, 2005. Companies are also subject to price floors for all services set at the service’s long-run incremental cost. Finally, they are also subject to applicable PUC rules relating to “discriminatory” and “predatory” pricing under Chapter 60 of the Public Utilities Code.

These relics of monopoly regulation—including price caps and floors—should be removed from the current system. Texas telecommunications policy should reflect the ongoing vibrant competition in many markets by immediately removing all price controls in deregulated markets to provide a positive incentive for companies to choose deregulation.

The Texas Legislature introduced competition into any telecommunications market in Texas with over 100,000 in population. The results have been spectacular. However, for market with populations between 30,000 and 100,000, the Legislature provided a test that has resulted in few smaller markets being brought into competition. The test is antiquated and should be modified. To ensure the competitive market test is current, technology requirements should include services such as IP, wireless and satellite technology to the list of possible competing technologies that the PUC may find to be present in the market.

Recommendations: *Remove the authority of the PUCT to regulate rates, tariffs, terms, and conditions of service and introduce competition in telecommunications markets without market size distinction, with the following changes to the Texas Public Utilities Code:*

- Sec. 65.051 and 65.052. Change the market test along these lines: “which have at least two competitors, which could come from any of the categories listed in current statute.”
- Sec. 65.202-65.205. Eliminate as outdated.
- Sec. 52.201 and 52.203. This should be changed to reflect the new market power test in 65.052.
- Sec. 52.055. Amend to be re-aligned with the new market power test.
- Sec. 65.054 and 65.055. Eliminate as not necessary once the population requirements for deregulated are removed.
- Sec. 51.002 and 52.002. Create definition and market rules regarding Internet Protocol Enabled service and Voice over Internet Protocol Service.
- Sec. 51.001(g). Update to eliminate dated pricing review requirements.
- Sec. 65.102(a)(3) and 65.153(c). Delete as unnecessarily restrictive in a de-regulated marketplace.
- Sec. 65.102 and 65.151. Update to remove burdensome reporting requirements.
- Eliminate LRIC requirements.
- Sec. 54.251(b), 54.3015, 65.102(a)(1), 65.102(a)(3), and 65.151. Amend to remove POLR requirements, as unnecessary, in a deregulated market.
- Sec. 65.102(a)(3) and 65.152. Amend regarding pricing flexibility and service quality. Specifically, the basic rates cap prior to USF revision needs to be deleted as obsolete. The deregulated company provision should be cleaned up to mirror the exemption from service quality standards for transitioning companies. Also the one-day informational notice requirement—by transitioning companies—for pricing and packaging changes is unnecessary and should be removed.
- Sec. 51.002(5)(F), 52.0585, 55.007, 55.022, 57.024, 57.025(3), 58.026, 58.258, 58.259, 59.027, 60.045, 60.045, 60.084, and 65.153(b)(2). Eliminate as they relate to tariffing as no longer necessary in a deregulated market.
- Sec. 52.251, 54.156, 55.004, 59.077, 60.006(3), and 60.041. Eliminate as outdated.
- Sec. 52.0584(b). Amend to remove section (a) relating to tariffed rates.
- Sec. 55.028. Amend to remove “at a reasonable tariffed rate.”
- Sec. 56.028. Amend to remove the sentence relating to the tariffed rate.

Reducing Discriminatory or Excessive Telecommunications Taxes and Fees

Telecommunications services continue to diversify and expand due to the recent developments in wireless, satellite, and Internet technologies. Voice service consumers, for example, can choose between traditional wireline, cellular, or Voice-over-Internet Protocol (VoIP) platforms. Further regulatory

improvements were made in Texas with the passage of Senate Bill 5 in 2005. Senate Bill 5 was a step in the right direction towards promoting regulatory reforms and competition, but it left mostly untouched the monopoly-based taxes and fees levied on telecommunications providers and consumers. There is still room for improvement.

Recommendation: *Promote healthy competition within the telecommunications industry by having a uniform method for determining property values.*

Texas' 21st century telecommunications tax structure is still based on a 20th century telecommunications regulatory model. Certain companies are treated as though they are still the "utilities" of old, while other, newer firms are not defined by such frameworks.

Early telecommunications policy grew out of the fact that there was a monopoly telephone service provider. The government can collect high taxes on such a business without creating additional significant economic distortions. In a competitive market, however, the same high taxes distort prices and therefore change consumer behavior and investments. Tax structures that treat the industry as though there is still only one hardwired telephone provider are harmful to competition and consumers.

One example of this is that certain telecommunications providers are appraised differently for the purposes of property taxes. In particular, wireline telephone companies are treated as "utility" companies, while other voice service companies are not. This creates a discrepancy in how different telecommunications properties are appraised for property taxes. Utility property is valued using "unit appraisal method," which has historically been used for utilities that operate in highly-regulated industries or across various taxing districts.

Most new companies entering the telecommunications market are not taxed in the same fashion as traditional companies. Their property is typically appraised using a summation approach rather than the unit appraisal method. As a result, lower tax assessments on certain companies can give them an unfair competitive advantage over pre-existing, or older companies. Because this violates the principle of "tax neutrality" within a certain industry, the state should look at ending discriminatory assessments on telecommunications properties.

- Amend Chapter 151, Tax Code, to ensure a uniform method in determining property value.
- Amend Sec. 36.051, Utility Code, so that calculating overall revenue complies with the updated definition of property value.

Recommendation: *Eliminate taxes on production goods that are used to deliver consumer telecommunications service.*

The Texas sales tax is levied on certain non-retail, or higher-order, telecommunications equipment that is not a consumer product. Examples are machinery, equipment, and software purchased by telecommunications companies that are used in delivering consumer-based products and services. Taxing this equipment at various stages along the production process places a hidden tax on consumers.

Examples of such equipment are as follows 1) antennas, 2) amplifiers, 3) poles, 4) wires and cables, 5) rectifiers, 6) duplexers and multiplexers, 7) receivers, 8) repeaters, 9) transmitters, modems, and routers, and 10) power equipment and storage devices. Telecommunications companies could not deliver retail consumer services without these items, though they are currently being taxed as though these were themselves retail goods. All in all, consumers are fronting the bill for almost \$400 million per year for equipment taxes. Over a five year period this will cost consumers almost \$2 billion; no small sum.

- Amend Chapter 171, Tax Code, to properly define what constitutes retail provider equipment to accurately reflect the above explanation.
- Amend Chapter 36, Utility Code, to change definition of property values as explained above to establish a reasonable rate base.

Recommendation: *Eliminate the "tax on a tax" application of the sales tax to taxes and fees on a telephone bill.*

Sales taxes levied on telecommunications services function in part as a "tax on a tax" since they are levied on other taxes, including the Federal USF charge, the Texas USF charge, and the Utility Gross Receipts Assessment. This double-tax costs Texas consumers over \$90 million per year.

Just as consumers are paying a double tax on telecommunications equipment at the time of retail purchase, so too are they paying taxes on charges and fees imposed on telecommunications companies by federal, state, and local governments. Upon payment for consumer retail services, the sales tax is being levied on charges such as utility gross receipts, the Texas USE, the Federal USE, and municipal franchise fees. Simply put, consumers are paying taxes on taxes and fees which were already built-in and passed down. Over a five year period from FY 2008 through 2012, consumers could have saved an average of \$113 million per year, or, \$500 million.

- Amend Sec. 151.061(o)(1), Tax Code, to specifically exclude fees from being taxed on a consumers bill.
- Amend Chapter 321 and Chapter 323, Tax Code, in accordance with the changes under Sec. 151.061.

Recommendation: *Reduce the Utility Gross Receipts Assessment tax to produce only enough money to pay for regulatory programs at the PUC, eliminating most of its contribution to general revenue.*

The Public Utility Commission receives roughly \$10 million per year in general revenue funds. That money goes to many essential functions of the Public Utility Commission. In addition, to general revenue and general revenue dedicated funds, the PUC levies taxes and fees to gain additional revenue. One of these taxes is the Utility Gross Receipts Assessment tax. While most of those funds are taken from public utility providers, they also apply to telecommunications carriers that do not provide local exchange telephone service. In the next biennium, the Comptroller estimates this tax will result in \$137,822,000 (seems large). This number should be reduced to provide only enough money to pay for regulatory programs at the PUC, not contribute to general revenue.

- Amend Sec. 16.001, Utility Code, to reduce the Utility Gross Receipts Assessment tax to produce only enough money to pay for regulatory programs.

Recommendation: *Reduce the 9-1-1 charge on telephone bills to provide only the revenue necessary to maintain and support the 9-1-1 emergency infrastructure.*

The FCC has imposed emergency 9-1-1 obligations on “interconnected” VoIP service providers where “interconnected” means any VoIP service that uses public switched telephone networks, including wireless, to initiate or terminate voice calls. By federal law, VoIP providers must 1) deliver all 9-1-1 calls to the local emergency call center, 2) deliver the caller’s call-back number and location when the call center is capable of receiving it, and 3) inform their customers of any limitations of 9-1-1 services.

The growing market penetration of cellular, wireless, and VoIP devices has prompted the USDOT to reassess the limitations of the current 9-1-1 emergency system. Their proposed goal is to implement a “next-generation” system which will enable 9-1-1 calls from any networked telecommunication device. The USDOT is currently conducting analysis relating to the implementation of such a system.

The USDOT information on next-gen 9-1-1 service states that the current financing system for 9-1-1 operations will likely be inadequate to fulfill next-generation 9-1-1 infrastructure goals. With an expected increase in federally mandated fees looming on the horizon, Texas should do what it can to decrease the in-state burden to local consumers and prevent the state from raiding surplus 9-1-1 funds.

In recent years, a \$90 million surplus of 9-1-1 fee revenues has been accumulating and has been allocated to help balance the general state budget. These 9-1-1 fees are imposed specifically for the use of supporting and maintaining emergency services, not balancing out budget shortfalls in other areas. If 9-1-1 fees are generating excess revenues that are not being used for their intended purposes, then it might be prudent to determine a new, more appropriate fee imposed on consumers.

- Chapter 51, Utility Code, amend with regards to the 9-1-1 tax as no longer necessary with federal controls in place. In addition, the current tax has been re-routed to general revenue. ★

