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Reducing Discriminatory or Excessive Taxes and Fees on High-Tech Services

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Findings

- Eliminate taxes on production goods that are used to deliver high technology consumer 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.

Introduction

High technology services, including cable television, Internet access, and telecommunications, 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 Voiceover-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, so we offer the following recommendations.

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

- Amend Chapter 151, Tax Code, to properly define what constitutes equipment used by a provider to deliver cable television service, Internet access service, or telecommunications services.

Texas has for decades exempted manufacturing equipment from the sales tax so that goods are only taxed once through the production process. Today new technologies in the high tech sector have spawned a new type of manufacturing—the production of high technology services such as cable television, Internet access, and telecommunications. The equipment used in producing these services, however, is often subject to the sales tax. Thus consumers wind up paying the sales tax twice.

The Texas sales tax is levied on certain non-retail, or higher order, telecommunications equipment that is not a consumer product. This includes 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.

Equipment that is used or consumed by a high technology provider in or during the provision, creation, or production of cable television service, Internet access service, or telecommunications services is akin to manufacturing equipment, and should be taxed accordingly, rather than being subject to the sales tax that is traditionally levied on retail goods and services.

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

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

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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 USF, the Federal USF, 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.

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.*

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

The Public Utility Commission receives roughly $10 million per year in general revenue funds to fund its activities. However, the PUC levies taxes and fees that contribute far more than this amount to general 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. This number should be reduced to provide only enough money to pay for regulatory programs at the PUC, so that there is no contribution above this amount to general revenue.

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

- 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.

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. ✮

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