

Telephone Excise Tax

by Brian Francis

The telephone excise tax generated \$5.2 billion in budget receipts for Fiscal Year (FY) 1999 [1]. This amounted to 7.4 percent of all excise taxes or 0.28 percent of total Federal Receipts. Two other major sources of Government revenue from the communications industry are the corporate income tax and the Federal Communications Commission (FCC) universal service fee. Together, these measures raised approximately \$18 billion in FY 1997. The telephone excise tax predates the income tax as well as the FCC. A brief history of this particular excise tax is provided below.

History

The telephone excise tax has been in effect for most years since it was enacted by the War Revenue Act of 1898. Originally designed as a luxury tax imposed on the few fortunate enough to own telephones, it was first used to provide funding for the Spanish-American War effort at the close of the 19th Century. The Act defined the base of the tax and set the rate in a single sentence.

“Every person, firm, or corporation operating any telephone line or lines is required to make, within the first fifteen days of the month, a sworn statement to the collector of the number of messages or conversations transmitted over their lines during the preceding month for which a charge of 15 cents or more was imposed, and for each such message or conversation to pay a tax of .01.”

The initial tax was short-lived, effective from July 1, 1898, to July 1, 1901, and appeared as a single line item in the assessments section of the *Annual Report of the Commissioner of Internal Revenue*. In its earliest years, the telephone excise tax was not a significant source of tax revenue. The \$314 thousand collected in FY 1900 are slightly less than the \$366 thousand received that year from a tax on chewing gum.

The War Revenue Act of 1917 greatly expanded the role of the Internal Revenue Service and revived the telephone excise tax. Under the heading of Public Utilities, the item “Telegraph, telephone and radio messages” excise taxes totaled \$6.3 million or

0.17 percent of total collections in FY 1918 [2]. The telephone excise tax stayed in effect after the First World War until repealed by the Revenue Act of 1924. The tax stayed off the books until it was reinstated by the Revenue Act of 1932 and has been in force ever since. Table 1 at the end of this article gives a complete time series of the receipts from the telephone excise tax.

Telegraph, telephone, and radio messages remained the only communications subject to tax until 1934, when leased wires were first shown separately. In 1943, a tax on local telephone service was enacted, with separate statistics shown in the *Annual Reports* along with the other two amounts. In 1954, the first category became “Long-distance telephone, telegraph, cable and radio, etc.” In 1962, “Toll” replaced “Long-distance” in this heading. General telephone service replaced local telephone service in 1963. Finally, in 1966, the single comprehensive category currently in use (i.e., the telephone excise tax) was adopted for all communications excise taxes.

Contemporary Tax

Liabilities for the telephone excise tax since Fiscal Year 1965 are shown in current dollars by Figure A, along with the tax rate on the right axis [3].

Figure B shows the same data in constant 1982-84 dollars. After correcting for inflation, the time series shows a modest rate of growth since 1983, when the current tax rate of 3 percent was set.

The telephone excise tax in force at the close of the 20th century had its roots in the Excise Tax Reduction Act of 1965. This Act defined the base for the tax as local telephone service, toll telephone service, and teletype service. Private services such as PBX and Centrex were granted exemptions from the tax on local telephone service [4]. The prior tax on telegraph service, wire, and equipment service was repealed. The rate was to be reduced to 3 percent effective January 1, 1966. Further reductions to 2 percent in 1967, 1 percent in 1968, and total repeal effective January 1, 1969, were established by the Act.

However, subsequent legislation extended the tax, adjusted the rate, or both, until finally, the Omnibus Reconciliation Act of 1990 made the tax permanent at a rate of 3 percent. Rate changes between

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Figure A

Telephone Excise Tax

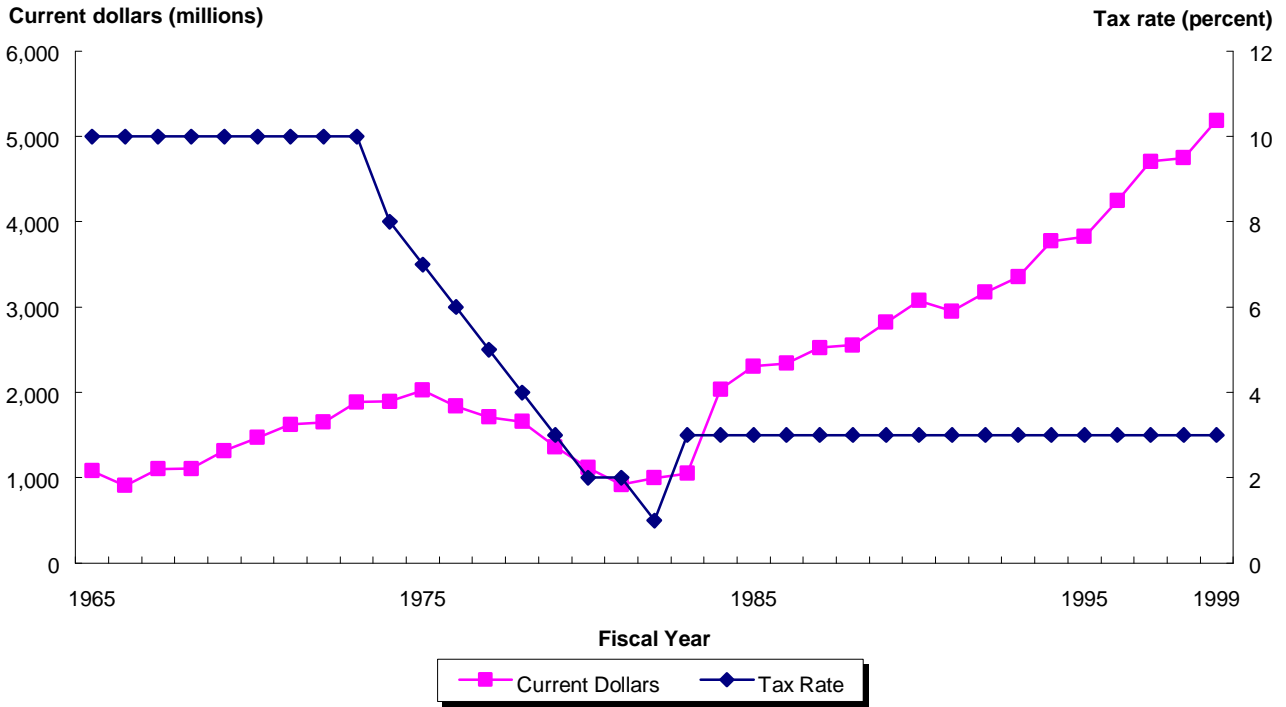
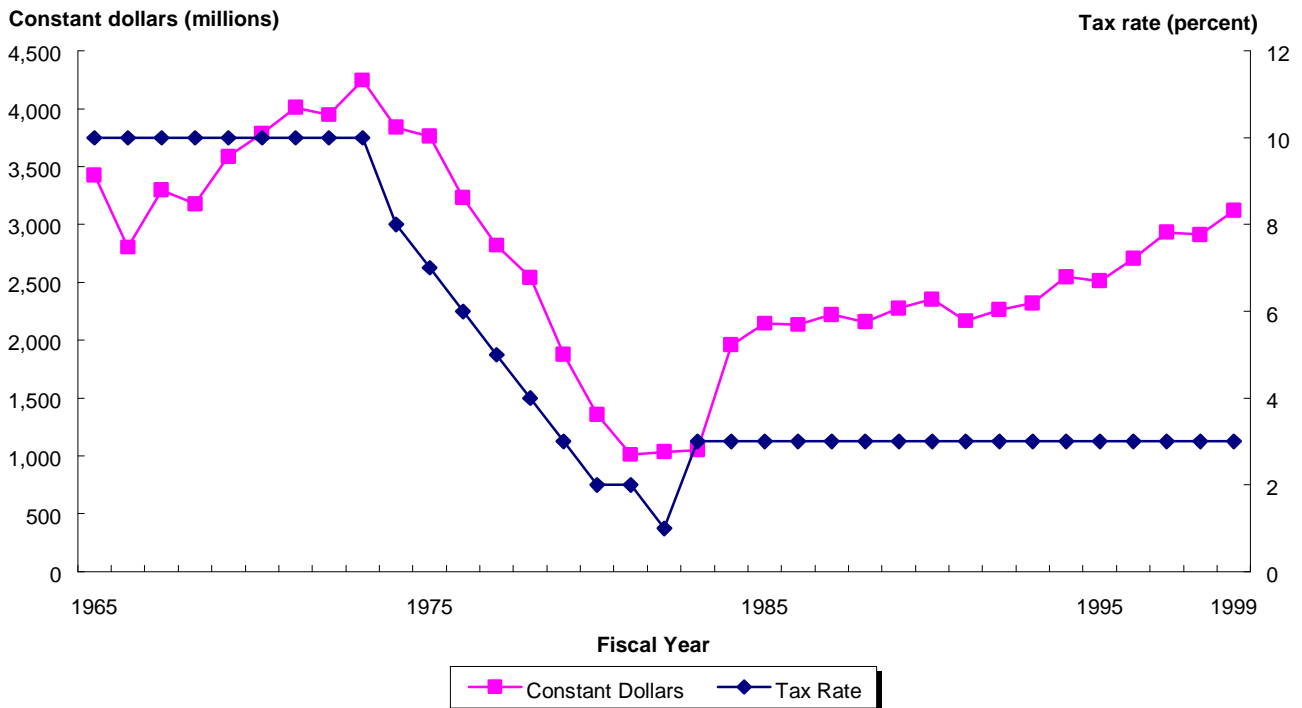


Figure B

Telephone Excise Tax



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FY 1974 and 1983 are evident in Figures A and B.

The extension of the tax, in the Taxpayer Relief Act of 1997, to prepaid telephone cards was a response to technological changes in the industry. Those changes have also rendered the tax on teletypewriter services obsolete. A detailed description of the telephone excise tax for FY 2000, available in IRS Publication 510, *Excise Taxes for 2000*, is reproduced below.

- Local telephone service**--Access to a local telephone system and the privilege of telephonic quality communication with most people who are part of the system and any facility or service provided in connection with the service. The tax applies to lease payments for certain customers premises equipment (CPE) even though the lessor does not also provide access to a local telecommunications system.
- Private communication service**--Private communication service is not local telephone service. Private communication service includes accessory-type services provided in connection with a Centrex, PBX, or other similar system for dual-use accessory equipment. However, the charge for the service must be stated separately from the charge for the basic system, and the accessory must function, in whole or in part, in connection with intercommunication among the subscriber's stations.
- Toll telephone service**--Telephone quality communication for which a toll is charged that varies with elapsed transmission time of each communication. The toll must be paid within the United States. It also includes a long distance service that entitles the subscriber to make unlimited calls (sometimes limited as to the maximum number of hours) within a certain area for a flat charge. Microwave relay service used for the transmission of television programs and not for telephonic communication is not a toll telephone service.
- Prepaid telephone cards**--A prepaid telephone card is any card or any other similar arrangement that allows its holder to get local or toll telephone service and pay for those services in advance.

The tax is imposed when the card is transferred by a telecommunications carrier to any person who is not a telecommunications carrier. The tax is based on the face amount of the card. If the face amount is not a dollar amount, the face amount will be determined under the regulations for section 4251 of the Internal Revenue Code.

Although the telephone companies collect the excise tax for the Internal Revenue Service (IRS), it is the end-users who are ultimately liable. If, for instance, a new telephone company neglects to include the telephone excise tax in its billing, users of the service may receive a bill from the IRS for taxes owed.

Exemptions

There are numerous exemptions to the excise tax on telephones. The list of exemptions shown below, may also be found in IRS Publication 510, *Excise Taxes for 2000*.

- Installation charges**--The tax does not apply to payments received for the installation of any instrument, wire, pole, switchboard, apparatus, or equipment. The tax does apply to payments for the repair or replacement of those items, incidental to ordinary maintenance.
- Answering services**--The tax does not apply to amounts paid for a private line, an answering service, and a one-way paging or message service if they do not provide access to a local telephone system and the privilege of telephonic communication as part of the local telephone system.
- Mobile radio telephone service**--The tax does not apply to payments for a two-way radio service that does not provide access to a local telephone system.
- Coin-operated telephones**--Payments made for services by inserting coins in coin-operated telephones available to the public are not subject to tax for local telephone service. They also are not subject to tax for toll telephone service if the charge is less than 25 cents. But the tax applies if the coin-operated telephone service is fur-

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nished for a guaranteed amount. Figure the tax on the amount paid under the guarantee plus any fixed monthly or other periodic charge.

- ❑ **Telephone-operated security systems**--The tax does not apply to amounts paid for telephones used only to originate calls to a limited number of security stations for security entry into a building. In addition, the tax does not apply to any amounts paid for rented communication equipment used in the security system.
- ❑ **News services and radio broadcasts of news and sporting events**--The tax on toll telephone service and teletypewriter exchange service does not apply to news services and radio broadcasts of news and sporting events. This exemption applies to payments received for messages received for one member of the news media to another member (or to or from their bona fide correspondents). However, the tax applies to local telephone services and related charges. The tax does not apply to charges for services dealing exclusively with the collection or dissemination of news for the public press or radio or television broadcasting. It also does not apply to charges for services used in the collection or dissemination of news by a news ticker service furnishing a general news service similar to that of the public press. For the exemption to apply, the charge for these services or facilities must be billed in writing to the person paying for the service, and that person must certify in writing that the services are used for one of these exempt purposes. However, toll telephone service in connection with celebrities or special guests on talk shows is subject to tax.
- ❑ **Common carriers and communications companies**--The tax on toll telephone service does not apply to WATS (wide area telephone service) used by common carriers, telephone and telegraph companies, or radio broadcasting stations or networks in their business. A common carrier is one holding itself out to the public as engaged in the business of the transportation of persons or property for compensation, offering its services to the public generally.

- ❑ **Military personnel serving in a combat zone**--The tax on toll telephone service does not apply to telephone calls that originate in a combat zone that are made by members of the U.S. Armed Services serving there if the person receiving payment for the call receives a properly executed certificate of exemption.
- ❑ **International organizations and the American Red Cross**--The tax does not apply to communication services furnished to an international organization or to the American National Red Cross.
- ❑ **Nonprofit hospitals**--The tax does not apply to telephone services furnished to income tax-exempt nonprofit hospitals for their use. Also, the tax does not apply to amounts paid by these hospitals to provide local telephone service in the homes of its personnel who must be reached during their off-duty hours.
- ❑ **Nonprofit educational organizations**--The tax does not apply to payments received for services and facilities furnished to a nonprofit educational organization for its use.
- ❑ **Federal, State, and local government**--The tax does not apply to communication services provided to the Government of the United States, the government of any State or its political subdivisions, the District of Columbia, or the United Nations. Treat an *Indian tribal government* as a State for the exemption from the communications tax only if the services involve the exercise of an essential tribal government function.

The Federal Communications Commission
The Federal Communications Commission (FCC) is not authorized to collect taxes. However, in section 254(d) of the Telecommunications Act of 1996, Congress mandated that “every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service.” Virtually all telecommunications companies provide

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interstate telecommunications service by providing access to long-distance lines and are expected to make contributions to the FCC.

The FCC determines the amount of contributions through a Universal Service Administrator who collects and tabulates end-user revenue data. The Commission then calculates contribution factors based on program requirements. In Calendar Year 1998, contributions to the FCC's High Cost and Low-Income Support Mechanisms accounts totaled roughly \$2.2 billion. Contributions to the Schools, Libraries and Rural Health Support Mechanisms accounts were about \$1.4 billion [5].

State of the Industry

In 1970, about 87 percent of households had telephone service. By 1997, that level had risen to roughly 94 percent. Telephone infrastructure has grown rapidly. For example, from 1984 to 1997, the number of access lines rose 80 percent, from 108 million to 194 million. However, in that time, the number of local exchange carriers decreased 32 percent from 75 to 51 [6].

Summary

The communications industry is subject to three separate assessments by two Federal agencies. The IRS collects the telephone excise tax, approximately \$5 billion per year, and the corporate income tax, about \$9 billion per year, and contributions to the FCC, \$3.6 billion for the most recent year. Revenue from these three measures will likely continue to grow under existing law. Recently, Internet communications companies have begun providing telephony at no charge [7]. The Advisory Commission on Electronic Commerce was created by the Internet Tax Freedom Act in 1998. The Commission was

formed to recommend policy regarding taxation of electronic commerce. In its report to Congress, April 3, 2000, the Commission recommended that the 3-percent telephone excise tax be repealed. On May 17, 2000, the House Ways and Means Committee favorably reported H.R. 3916 (as amended) to repeal the telephone excise tax in the Internal Revenue Code of 1986.

Notes and References

- [1] See Tables 3-1 and 3-4, *Analytical Perspectives, Budget of the United States Government Fiscal Year 2001*.
- [2] See *Annual Report of the Commissioner of Internal Revenue 1918*, U.S. Government Printing Office, for a description of revenue measures in the early years of the 20th century.
- [3] Telephone excise taxes were published in the *Annual Report of the Commissioner* and currently can be found in Table 20 in the historical section of the *SOI Bulletin*.
- [4] PBX (Private Branch Exchanges) and Centrex are private telephone systems used by businesses where switching gear is bought or leased. These systems allow businesses to integrate voice and data equipment.
- [5] Information in this section is from the Federal Communications Commission Internet web site, www.fcc.gov.
- [6] *Statistical Abstract of the United States, 1999*, Table 926.
- [7] See "The Next Web Battle: Phone Calls," *The Wall Street Journal*, December 27, 1999, p. B1.

SOURCE: IRS, Statistics of Income Bulletin, Publication 1136, Spring 2000.

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Table 1.--Telephone Excise Tax Receipts, 1899-1999

[Money amounts are in thousands of dollars]

Year	Receipts	Year	Receipts
1899.....	211	1960.....	738,297
1900.....	314	1961.....	827,302
1901.....	360	1962.....	843,478
1902.....	34	1963.....	880,605
		1964.....	910,196
1918.....	6,299	1965.....	1,078,937
1919.....	17,902	1966.....	907,917
1920.....	27,677	1967.....	1,101,853
1921.....	28,442	1968.....	1,105,478
1922.....	29,272	1969.....	1,316,378
1923.....	30,381	1970.....	1,469,562
1924.....	34,662	1971.....	1,624,533
		1972.....	1,650,499
1933.....	14,565	1973.....	1,885,228
1934.....	19,251	1974.....	1,892,731
1935.....	19,741	1975.....	2,023,744
1936.....	21,098	1976.....	1,837,362
1937.....	24,570	1977.....	1,708,778
1938.....	23,977	1978.....	1,656,736
1939.....	24,094	1979.....	1,362,193
1940.....	26,368	1980.....	1,117,834
1941.....	27,331	1981.....	919,749
1942.....	75,022	1982.....	998,503
1943.....	158,161	1983.....	1,048,317
1944.....	231,474	1984.....	2,034,965
1945.....	341,587	1985.....	2,307,607
1946.....	380,082	1986.....	2,339,153
1947.....	417,690	1987.....	2,522,062
1948.....	468,776	1988.....	2,555,082
1949.....	535,911	1989.....	2,820,528
1950.....	559,620	1990.....	3,075,209
1951.....	644,980	1991.....	2,952,522
1952.....	705,771	1992.....	3,173,000
1953.....	775,873	1993.....	3,351,600
1954.....	771,981	1994.....	3,774,000
1955.....	520,449	1995.....	3,825,700
1956.....	557,233	1996.....	4,243,400
1957.....	613,210	1997.....	4,706,800
1958.....	650,185	1998.....	4,747,227
1959.....	690,435	1999.....	5,185,000