Statement of Jeff Dircksen
Director of Congressional Analysis, National Taxpayers Union & Foundation

before the
United States Senate
Committee on Commerce, Science, and Transportation

on
Communications, Taxation, and Federalism

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Chairman Inouye, Vice Chairman Stevens, and Members of the Committee, my name is Jeff Dircksen, and I am the Director of Congressional Analysis for National Taxpayers Union Foundation, the education and research arm of the National Taxpayers Union (NTU). NTU is America's oldest and largest grassroots taxpayer organization with over 362,000 members in all 50 states. You can learn more about NTU and NTUF online at www.ntu.org.

I appreciate the opportunity to testify on the topic of communications, taxation, and federalism. This hearing addresses some of the most important technological and economic issues facing America. <u>I am here on behalf of NTU and its membership to urge you to extend the Internet Tax Moratorium and to ensure that the Internet and online transactions remain free from predatory taxes</u>.

Today, I want to share three taxpayer concerns regarding taxing Internet usage and the application of additional taxes or fees to Internet access or transactions. In addition, I will suggest policy alternatives that would be both pro-free market and pro-taxpayer in their orientation. First, state and local governments already place sizeable taxes, fees, and other charges on taxpayers who subscribe to various telecommunications services, whether wired, wireless, or online. Second, allowing governmental entities to increase this burden would be counterproductive for consumers and telecommunications providers. Third, the Supreme Court's 1992 *Quill* ruling has protected taxpayers by ensuring tax competition among state and local governments who might otherwise engage in round after round of tax hikes in a "race to the top."

Finally, on behalf of our members, I would urge you to consider how taxpayers would be better served by low-tax, pro-free market policies that encourage economic growth and innovation in the telecommunications sector (in contrast to higher taxes, fees, and additional regulation).

108 North Alfred Street ★ Alexandria, Virginia 22314 ★ Phone: (703) 683-5700 ★ Fax: (703) 683-5722 ★ Web: www.ntu.org

(1.) Taxpayers already face sizeable taxes, fees, and other charges for telecommunications services.

In 2000, the National Conference of State Legislatures estimated that there were nearly 11,000 state and local governmental entities that could levy taxes or fees on telecommunication activities, including franchise taxes, utility taxes, line access and right-of-way charges, 911 fees, relay charges, and maintenance surcharges.[1] Research shows that over time, the users of telecommunication services have consistently shouldered higher tax burdens on telecommunications products when compared to taxes on other goods and services. A Council on State Taxation (COST) report released in 1999 found that consumers faced an effective state and local tax rate of 13.74 percent, which was more than double the 6 percent rate that imposed on other taxable goods.[2] A 2005 update to that report found that the effective rate confronting taxpayers had risen to 14.17 percent, while general business taxes had increased to 6.12 percent from 6 percent.

While a recent report produced by the Heartland Institute and the Beacon Hill Institute at Suffolk University found a slightly lower tax rate than the COST study, it did estimate that the average tax rate for telecommunications services was either 13.52 percent or 11.04 percent, depending upon whether Internet access taxes were included or not. Table 1 below summarizes the average monthly bill, tax paid, and tax rate that consumers face. That rate is still double the average general sales tax, which was 6.61 percent in the study. Please bear in mind also that Heartland/Beacon Hill's findings reflect adjustments to the methodology for which COST's study was criticized by self-interested local officials. Using the average annual taxes and fees paid on cable TV and telephone services (both wired and wireless), the authors estimate that the total annual tax bill paid by consumers is $37 billion. The estimate does not include "losses due to reduced investment, productivity, and consumption."[3]

Table 1. The Average Monthly Bill, Tax Paid, and Tax Rate for Communication Services

Service	**Average Monthly Bill**	**Average Tax Paid**	**Average Tax Rate**
Cable TV	$52.36	$6.12	11.69%
Wireline Phone	$49.33	$8.50	17.23%
Wireless Phone	$49.98	$5.89	11.78%
Subtotal	$151.67	$20.51	13.52%
Internet Access	$36.50	$0.26	0.71%
TOTAL	$188.17	$20.77	11.04%

Source: Heartland Institute Policy Study #113, May 2007

Lowering the taxes on telecommunications to even the average sales tax rate would put some money in the pockets of consumers. The authors of the Heartland and Beacon Hill Institute study observe, "The average household would save $125.76 a year if taxes and fees on cable television and phone calls were the same as the average general sales tax on clothing, sporting goods, and household products."[4] The savings may not appear to be significant to those of us living in the Washington metro area, but for consumers in other areas of the country the amount might not be a paltry matter. (Of course, the savings could be even more substantial if the tax rates were reduced to zero for the communications services.) I make this point because when I had the opportunity to testify on these issues in 2001, I mentioned that I had just learned that my brother-in-law was planning to stop farming near Gann Valley, South Dakota, and start working for a local Internet service provider. For some potential Internet or telecommunications customers in Gann Valley, Woonsocket, or Viborg, South Dakota, those savings might make the difference between connecting to a world outside of the Great Plains or not.

(2.) Additional taxes on telecommunications services would be counterproductive for consumers and service providers.

Additional taxes on Internet access or other telecommunications services may further slow the adoption of broadband technologies in the U.S. According to data from the Organisation for Economic Co-operation and Development (OECD), as of December 2006, the U.S. ranks 15th out of 30 OECD countries for broadband subscribers per 100 inhabitants.[5] Table 2 below shows that the U.S. trails countries such as Denmark and Canada, but also Luxembourg.

Table 2. Broadband Subscribers per 100 Inhabitants

Country	Rank
Denmark	1
Netherlands	2
Iceland	3
Korea	4
Switzerland*	5
Norway	6
Finland	7
Sweden*	8
Canada	9
Belgium	10
United Kingdom	11
Luxembourg	12
France	13
Japan	14
United States	15

Notes: *Data for Sweden and Switzerland are preliminary estimates based on September 2006 data.

Source: OECD

Broadband technologies are highly price-elastic, meaning that consumers are sensitive to changes in price, including the imposition of additional taxes and fees. Steve Titch, a policy analyst with the Reason Foundation, points out that a 1 percent hike in the price of wireless service leads to a 1.29 percent drop in demand. The demand for cable TV falls three percent in response to a one percent rise in the price of the service. Titch concludes, “This elasticity also is why legislators should avoid the temptation to ‘simplify’ telecom taxes by raising them all to match the service taxed at the highest rate. In addition to being simplified, telecom taxes must be lowered."[6]

Such taxes can cause consumers to alter their decision-making processes and to select services based on taxes rather than on the true cost or quality of what is being offered. Producers may decide to forego an investment that they might have made in the absence of the tax structure. These economically inefficient decisions lead to a loss of both consumer and producer surpluses, resulting in what economists would call a "deadweight loss." The annual deadweight loss due from taxes and fees on cable has been estimated to be as high as $2.6 billion annually. [7] The economic loss to the country from wireless taxes and fees is even larger – $8.8 billion a year.[8] A 2006 analysis by economist Austan Goolsbee found that if taxes had been levied on broadband technologies in 1998 that the resulting deadweight loss would have slowed the entry of broadband suppliers into some marginal markets.[9] According to Goolsbee, "[T]he deadweight loss adjustment associated with the impact of taxes on diffusion, $70 million, exceeds the conventional deadweight loss by a factor of 2 (raising the total [deadweight loss] from around 180 percent of revenue to 434 percent of revenue.)"[10]

Rather than aggravating these economic losses with new or higher taxes, Congress should adopt a policy that bans new taxes and repeals those already in place (or at least lowers them). NTU has supported the temporary extensions of the Internet tax moratorium, while urging a permanent ban on access taxes and other telecommunications fees. Such a ban would remove the economic inefficiencies and uncertainties associated with temporary moratoriums, thereby sending a strong and clear signal to taxpayers and service providers: namely, that broadband and wireless are technologies that will be allowed to grow and innovate without the specter of the "tax man" lurking in the shadows.

(3.) The *Quill* ruling has protected taxpayers by ensuring tax competition among state and local governments.

Any scheme that intends to simplify, streamline, or make sales taxes "fairer" online is just one step away from trampling the Supreme Court's 1992 *Quill* ruling. Consumers should be wary of this backdoor attempt to run roughshod over the Court's restrictions on taxing phone and catalog sales. If such a system of extraterritorial collection is allowed, Congress will have opened the door to any number of potential tax cartels that will eventually harm rather than help taxpayers.

Forty-five states and the District of Columbia impose some type of a broad-based retail sales and use tax. [11] The Federation of Tax Administrators calculates the median state sales tax rate to be 5.5 percent.[12] The sales taxes levied on consumers is likely higher, however, since local governments in 34 states are also allowed to levy a sales tax. Consequently, there are an estimated 7,458 governmental entities that can impose a sales or use tax.

In almost every case, the taxes imposed by local governments are "add-ons," or taxes that are in addition to the state's base sales tax rate. One must ask whether it is reasonable to believe that local elected officials would be willing to eliminate these "add-ons" in the name of simplification. Instead, taxpayers are likely to see an escalation of rates – a "race to the top" – especially when politicians can hide behind the cloak of "simplification" and "harmonization."

In reality, such actions would essentially kill tax competition among states. Elected officials would have little incentive to keep tax rates – or government expenditures – in check. The current sales tax structure authorizes states and localities to determine taxing priorities, allowing tax bases and rates to vary as legislative bodies see fit. NTU frequently receives letters and email messages from individuals who are considering relocating their families and businesses and want to find information on state and local tax burdens. These individuals see tax competition among states as extremely beneficial.

(4.) Pro-taxpayer, pro-market policy suggestions that encourage economic growth and innovation in the telecommunications sector.

The following is a list of recommendations that would benefit taxpayers through lower taxes and economic expansion, as well as through innovation in the quality and delivery of telecommunication services.

- A permanent ban on Internet access taxes. As NTU's Senior Government Affairs Manager Kristina Rasmussen noted in a January 5, 2007 letter to Senators Wyden, McCain, and Sununu, "Since its enactment in December 2004, the Internet Tax Nondiscrimination Act has stopped any new taxes targeted at Internet access services. This bill and its predecessors have helped to create a dynamic environment where the Internet is thriving and bringing advanced communication capabilities to millions. Keeping the burden of new government-mandated access charges off Internet service has made entry to the information superhighway more affordable for Americans from all walks of life." Making the moratorium permanent would continue to keep that information superhighway affordable, today and in the future.

- A permanent ban on levying new discriminatory taxes on wireless services. Local and state governments believe wireless taxes, fees, and surcharges are a "cash cow" for the 21st Century. Yet, they fail to consider that the total wireless tax and fee burden can exceed 20 percent in some areas – a higher effective tax rate than the typical middle-class consumer pays on a 1040 federal income tax return. Again, higher wireless taxes will cause consumer demand to fall and limit the ability of service providers to enhance current offerings or develop new ones.

  The fact is, all too many officials in states and localities have been oblivious, and often contemptuous, toward this miserable situation. The City of Corvallis, Oregon provides but one example of where elected leaders resorted to a noxious tax scheme to make wireless services far less affordable. Voters demolished this proposal when it was referred to them last fall, but this laudable outcome entailed extraordinary efforts on the part of local residents (including our own members) to beat back the tax hike. Until citizen activists can establish comprehensive tax limitation and reduction measures in their communities, it is perfectly reasonable for Congress to set some sensible boundaries under federal law (just as it did with the Internet Tax Freedom Act).

- Repeal the remainder of the phone excise tax. While the Treasury's decision to forgo collection of the phone excise tax on long distance telephone calls was a step in the right direction, action should be taken to repeal the tax that is still being levied on local calls.

- Adopt business activity tax simplification legislation. The integration of the Internet and telecommunications technologies has allowed businesses to expand across state lines, and interstate business activities are now commonplace. However, these developments have created confusion about when states are permitted to collect income taxes from out-of-state companies conducting certain activities within their jurisdiction. Unfortunately, governments are increasingly defining "substantial nexus" differently, leading to a complex matrix of tax rules. Congress should adopt legislation that contains specific standards that define when firms should be obliged to pay business activity taxes.

- Provide clarification on whether "acquired transactions" are taxable or not. In its January 2006 report to this Committee entitled "Internet Access Tax Moratorium: Revenue Impacts Will Vary by State," the Government Accountability Office (GAO) argued that the current Internet tax moratorium does not exempt certain "acquired services" from taxation. These services include "high-speed communications capacity over fiber, acquired by Internet service providers (ISP) and used to deliver Internet access."[13] However, GAO's view is not accepted by all state tax officials or representatives of the telecommunications industry. We would recommend exempting such transactions to prevent state or local governments from making an end-run around the moratorium.

- Maintain the integrity of the spectrum auctioning process. Competitive bidding for taxpayer-owned airwaves has been successful all around, by providing a fair price for a valuable commodity, yielding billions of dollars in potential deficit reduction, and fostering the expansion of telecommunications services. Yet, Congress and the FCC continue to experience pressure from certain businesses seeking exceptions or favorable treatment during the auctioning process. Furthermore, disgruntled rivals in the same or even other industries seek regulatory action to enjoin common business decisions such as mergers. The proper response to such pleas is not additional intervention in the market, but rather providing the spectrum (through competitive auctioning) that will allow all comers to follow through with their business plans and offer consumers more choices.

- Reexamine unproductive subsidies. To give just one example, the Universal Service Fund's "High Cost" program, which subsidizes phone service in certain areas (often rural), was created as a way to further the goal set out by the 1934 Communications Act to provide reasonably priced communications across the nation. According to the Office of Management and Budget's Program Assessment Rating Tool, High Cost is rated "Results Not Demonstrated" because it "does not measure the impact of funds on telephone subscribership in rural areas or other potential measures of program success, nor does it base funding decisions on measurable benefits." A program whose purpose has been firmly implanted for decades should have established benchmarks for success by now, but apparently not in this case.

Conclusion

Given the potentially destructive impact that expanding or raising Internet and telecommunications taxes could have on this important economic sector, the remedy could not be clearer: Congress and the states should declare this tax territory permanently "off limits." Again, I appreciate the opportunity to testify here today, Mr. Chairman. Our membership is grateful that the voices of taxpayers are being heard as well as recognized. I look forward to your questions.

ENDNOTES

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[1] Scott Mackey, "Telecommunications and the Tangle of Taxes," *State Legislatures*, February 2000, www.ncsl.org.

[2] Scott R. Mackey, Testimony before the House Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, Oversight Hearing on State Taxation of Internet Telecommunications Services, June 13, 2006.

[3] David Tuerck et al., "Taxes and Fees on Communication Services," The Heartland Institute, Policy Study #113, May 2007, www.heartland.org, p. 22.

[4] David Tuerck et al.

[5] Organisation for Economic Co-operation and Development, "OECD Broadband Statistics to December 2006," www.oecd.org/sti/ict/broadband.

[6] Steve Titch, "The $37 Billion Telecom Tax Burden," www.reason.org, May 1, 2007.

[7] Jerry Ellig and James Nicholas Taylor, "The Consumer Costs of Wireless Taxes and Surcharges," *Working Paper in Regulatory Studies*, Mercatus Center, March 2006, cited in David Tuerck et al.

[8] Ibid.

[9] Austan Goolsbee, "The Value of Broadband and the Deadweight Loss of Taxing New Technology," *Contributions to Economic Analysis & Policy*, Vol. 5, Issue 1, 2006.

[10] Austan Goolsbee, pp. 19-20.

[11] Harley T. Duncan, "State and Local Retail Sales Taxes, Submitted to the President's Advisory Panel on Federal Tax Reform," Federation of Tax Administrators, April 2005.

[12] Federation of Tax Administrators, "State Sales Tax Rates and Vendor Discounts," January 1, 2006, www.taxadmin.org/fta/rate/vendor.pdf.

[13] United States Government Accountability Office, "Internet Access Tax Moratorium: Revenue Impacts Will Vary by State," January 2006, Highlights.