

**TESTIMONY OF SENATOR JAMES F. CLAYBORNE, JR
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Hearing on H.R. 5793, the “Cell Tax Fairness Act of 2008”

House Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

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Chairwoman Sanchez, Representative Cannon, and members of the Subcommittee, my name is James Clayborne, and I am the Assistant Majority Leader of the Illinois State Senate. I am also a member of the National Conference of State Legislators’ (NCSL) Communications, Financial Services & Interstate Commerce Committee which recently reaffirmed its communications policy statement calling for fair and equitable taxation of communications services.

Thank you for the opportunity to appear before you today to testify regarding the importance of H.R. 5793, the “Cell Tax Fairness Act of 2008” to my constituents and the more than 9.5 million¹ wireless consumers in Illinois. Representatives Lofgren and Cannon are to be commended for the broad bi-partisan support they have garnered for this bill.

As you might imagine, as a state legislator, any federal bill limiting a state’s ability to tax is something that I take very seriously. Our system of Federalism provides state and local policymakers with the authority to decide how states should impose taxes on individuals and businesses that reside within their jurisdictions. The states’ authority to impose taxes that raise revenues to fund government services is a concept that I strongly support.

However, I believe that another fundamental tenet of our nation’s tax system is that taxes should be levied fairly on our citizens, particularly in situations where multiple levels of government may have authority to tax. One only needs to look as far as his or her own wireless bill to see that there is nothing fair about the countless number of taxes and fees imposed upon wireless services today.

The purpose of H.R. 5793, precluding *new discriminatory* taxes from being added on top of the existing excessive level of taxes imposed upon wireless services, is an idea that is hard to disagree with. While convergence, competition and the dynamic changes that have taken place within the communications industry makes it critical for state policymakers to simplify and reform the current state and local taxes imposed upon all communication services and property, that goal is going to take some time to accomplish. It makes sense that state and local governments should not be enacting new discriminatory impositions when policymakers and the industry are continuing to work

¹ FCC, *Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Service: Twelfth Report*, FCC 08-028 (Feb. 4, 2008).

towards eliminating the ones that currently exist. Specifically for services that consumers rely upon for their communication, information and public safety needs

My focus here today will be to talk about how we got to where we are today and why I believe that taking a “time-out” from having new, additional discriminatory taxes imposed on wireless services is important to my constituents and consistent with the principles adopted by NCSL at its annual meeting.

Highlighting the problem

The tax structure imposed upon the communications industry today is a carryover from the days when the industry was operated by Ma Bell as a rate regulated utility. This tax structure was created well before the first wireless call was ever made. As regulated utilities, providers were subject to taxes under statutes applicable to "public utilities." The taxes imposed included gross receipts, franchise and other industry-specific taxes that were then passed on to consumers in the rates as part of the regulatory rate setting process. The phone company never had to worry about the consumer looking for a cheaper alternative because there was no competition in the marketplace. State and local governments could tax telecommunication services at much higher rates than any other goods and services without worrying about an outcry from unsuspecting constituents, because “it was just the phone company raising rates again.”

Since the introduction of wireless services in the late 1980’s and the passage of the Federal Telecommunications Act of 1996, the marketplace for communication services has changed substantially. Communications services are no longer provided by only a single provider, the “rate-regulated” utility. Consumers now have many options to choose from for their communications services as a number of extremely competitive industries bring innovation and change to consumers at a rapid pace.

The wireless industry alone provides communication services to over 260 million consumers. That is a staggering number of consumers enjoying the benefits of wireless mobility when you consider that only fifteen years ago there were just 13 million wireless consumers. The days of wireless services being considered a luxury that only the wealthy can afford are over. Today these services are critical to my constituents and, as with many other wireless consumers across the country, are considered a necessity. Likewise, wireless broadband services may be the only access that many consumers have to the internet. For better or worse, we can all be “connected” 24/7 if we choose to do so.

Unfortunately, the tax structure hasn’t kept pace with all the exciting innovation and technological changes taking place in the industry. The January 2008 issue of *Governing* magazine stated “And yet, state tax structures, developed at a time when computers — "thinking machines" — were the stuff of science fiction, and the American economy flourished with the automobile industry, have failed to evolve. To take one example, there is the outmoded way in which telecommunications companies are taxed. A reliable, high-quality and affordable telecommunications system is essential to the economic competitiveness of states — to say nothing of the nation. And yet, these

systems are subject to very high taxation rates in a number of states — by a tax approach set when the industry, dominated by one telephone company, was highly regulated.”²

Instead of undertaking the difficult task of reforming the tax structure for the industry in total, the wireless industry and its consumers have seen many of these antiquated “utility” taxes from the last century simply extended to wireless services under the guise of “leveling the playing field.” I support this bill because I don’t believe that making the situation worse before we tackle the difficult task of making it better for my constituents is the right answer.

The study published by Mr. Mackey earlier this year indicated that the national average rate of federal, state and local taxes and fees on wireless services is 15.19% compared to the average rate imposed upon other goods and services of 7.07%.³ That means the rate of tax on wireless services is more than double the rate on other goods and services! When I look at my home state of Illinois, it is ranked the 9th highest in the country with an average tax rate of close to 17%. It appears that we have some work to do to in my state to try to lower the rate imposed on wireless services to the rate imposed upon other goods and services, which averages about 8-9%.

A tax rate of 17% imposed upon services that I believe are critical to many of my constituents is burdensome, but imagine adding an additional tax on wireless services to that rate. I was very surprised to learn that a County in my state actually attempted to do just that last year. Cook County, Illinois, which encompasses most of the City of Chicago, was seeking to impose a \$4 “per line, per month” tax on communication services. There was no specific purpose given to justify the imposition of this tax solely on communication consumers – rather, the revenue was going to be used to plug a hole in the County’s general fund.

Had the proposed Cook County tax been enacted, the rate of taxes/fees on wireless services purchased by citizens in the City of Chicago would have increased to, on average, a rate of 24%. Now, if consumers in Cook County had the opportunity to approve this new tax, then I might not question the fairness of it. However, the county council was deciding for wireless consumers – the county was not going to put this proposal to a vote of the people. After the wireless industry educated its consumers about this new proposed “phone tax,” over 3,300 consumers took the time to contact their county officials to speak out against this tax. The actions of these consumers in Cook County demonstrate just how unpopular these targeted wireless taxes are with consumers.

When you consider how important wireless services have become to consumers today, taxing these services at such an excessive level is counterintuitive to me. Rates frequently approach the level of so-called “sin” taxes. Policymakers typically impose sin taxes when they want to discourage consumption of certain products, such as alcohol and tobacco. It is hard to understand why a service that many of my constituents consider a

² Katherine Barrett & Richard Greene, *Growth & Taxes*, Governing Magazine (January 2008).

³ Scott Mackey, *Excessive Taxes & Fees on Wireless: Recent Trends*, State Tax Notes (Feb. 18, 2008).

safety lifeline is taxed at nearly 20% per month. A rate meant to discourage usage, not encourage it.

I believe we all can acknowledge that communication services, and wireless services in particular, are a vital component of this country's economic growth and stability. Mr. Mackey cites several facts in his testimony on the productivity benefits that the wireless industry provides to the overall economy. It is hard to believe that any reasonable policymaker would continue to think that imposing new discriminatory taxes on wireless services is appropriate.

Protecting wireless consumers from excessive taxes is important to my constituents

As has been mentioned before, wireless services are no longer considered a luxury. For many Americans, these services are crucial to their everyday lives and yet they are taxed at levels that are double or even triple the rates of tax imposed on other goods and services. Imposing regressive consumption taxes on consumers purchases of wireless services disproportionately impacts low and middle income consumers which can put this critical service out of reach for some of my constituents that need it the most.

According to the Pew Internet & American Life Project, when respondents were asked how hard it would be to give up a specific communication service, cell phones received the top ranking over the Internet and television.⁴ The Pew study also found that 84 percent of English-speaking Hispanics, 71 percent of African-Americans and 74 percent of non-Hispanic white Americans have cell phones.⁵

As was stated before, wireless devices are being used to do far more than just make phone calls. Wireless technology also provides people with the ability to remain connected to friends, family and, in this new information age, to be able to access the Internet. Recent studies have shown that minorities constitute a growing proportion of total demand for wireless, particularly the newest data services, like broadband.

On a typical day, 77 percent of all Americans with cell phones have sent or received text messages, taken a picture, played a game, sent or received e-mail, accessed the Internet, recorded a video, played music, sent or received an instant message, used a map, or watched a video on their cell phone.⁶ Breaking down the details, the highest percentage of use is from minorities: 90 percent of English-speaking Hispanics and 77 percent of African-Americans have done at least one of these activities compared to 73 percent of non-Hispanic white Americans.⁷

Adoption of new technologies, in particular the use of wireless phones and wireless broadband, has driven and improved productivity, economic growth, and

⁴ John Horrigan, *Mobile Access to Data and Information*, Pew Internet & American Life Project (March 2008).

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

household income in the United States. Recent studies have demonstrated that policies supporting affordable wireless services that allow for increasing wireless use should lead to income and productivity gains by all Americans, particularly low income wireless users.

Whether it is a small business owner tracking orders “on the go,” an employee answering e-mails on a wireless device outside of the office, or a family physician using a handheld device to input patient information and prescriptions, wireless has delivered enhanced efficiencies and greater convenience. Taxing wireless services at a rate that is more than double the rate imposed upon other goods and services is artificially increasing the cost of these services which in turn hurts the economic gains that could be achieved by having a more rational tax policy.

Concept is consistent with NCSL Telecommunications Tax Reform Principles

Over the past eight years, NCSL has made communications tax reform a major priority for states to consider. The Committee as well as a separate task force has spent considerable time educating state policymakers on the need to simplify and modernize the taxes imposed upon communications services as well as the benefits in doing so.

The most recent set of principles for communications tax reform that have been unanimously endorsed by the NCSL are set forth below:

TAXATION OF COMMUNICATIONS SERVICES

Transaction taxes and fees imposed on communications services should be simplified and modernized to minimize confusion, remove distortion and eliminate discrimination regarding the taxability of telecommunications services. The National Conference of State Legislatures encourages elected policymakers at all levels of government to work together to simplify, reform and modernize communications taxes based upon the following principles:

Tax Efficiency: taxes and fees imposed on communications services should be substantially simplified and modernized to minimize confusion and ease the burden of administration on taxpayers and governments.

Competitive Neutrality: transaction taxes and fees imposed on communications services should be applied uniformly and in a competitively neutral manner upon all providers of communications and similar services, without regard to the historic classification or regulatory treatment of the entity.

Tax Equity: Under a uniform, competitively neutral system, industry-specific communications taxes are no longer justified, except for fees needed for communications services such as 911 and universal service.

State Sovereignty: Other than the prohibition of taxes on Internet access, NCSL will continue to oppose any federal action or oversight role which preempts the sovereign and Constitutional right of the states to determine their own tax policies in all areas, including communications services.⁸

Except for the very last provision addressing state sovereignty, the concepts in H.R. 5793 are very consistent with this policy statement. Under a uniform and competitively neutral system, industry specific taxes are no longer justified. Unfortunately, without proceeding with the reforms needed to the current tax structure, the system will remain confusing and inequitable. Extending industry specific “utility” taxes to wireless services is not the right answer. The concepts in H.R. 5793 are intended to guard against having the taxation of communications services become more onerous before the reforms set forth in the NCSL policy statement can be implemented.

Even though communications tax reform has been a major topic at NCSL, little progress in achieving such reforms has been made. One area where we have seen moderate success has been in the simplification of some of the existing taxes by reducing the number of returns communications providers are required to file. Illinois was one of those states, where several local impositions were consolidated into one tax that is filed with the state, significantly reducing the number of returns required to be filed that was required when returns were filed with the local governments.

While the simplification effort was helpful, the state still has not engaged in serious discussions with stakeholders about formulating a plan to reduce the high rate of taxes imposed upon communication consumers. Given the budget deficits that many states will be facing, I believe it will be difficult to quickly accomplish the reform that is required to reduce the existing excessive rates of taxes on communication services any time soon.

Having said that, it is an issue that we must continue to focus on. In the interim, we should ensure that no new discriminatory taxes will be imposed on wireless services. As a state that currently imposes an onerous tax burden on communication services, I can honestly state that once these taxes are in place they are very hard to eliminate. Preventing the imposition of new burdensome taxes on consumers while we try to fix the existing system makes a lot of sense.

Last year, it was estimated that wireless consumers in the state of Illinois paid almost \$1 billion in state, local and federal taxes and fees imposed upon their wireless services. By anyone’s measure, be it from a state or federal perspective, that is a lot of money for one subset of consumers to pay on an essential service. That is why I strongly support the passage and enactment of H.R. 5793, the “Cell Tax Fairness Act of 2008.”

⁸ Unanimously passed the NCSL Communications, Financial Services and Interstate Commerce Committee Business Meeting, November 28, 2007 – Passed on voice vote during the full NCSL Business Meeting November 30, 2007 – Passed on voice vote during NCSL Annual Business Meeting, July 25, 2008.

Thank you again for this opportunity to speak to you today. I would be happy to answer any questions that you might have at the appropriate time.