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THE FUTURE OF STATE AND LOCAL COMMUNICATIONS TAXES

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Overview

- ▶ Federal communications tax-related legislation.
- ▶ State communications tax-related proposals & legislation.
- ▶ The common denominator (with one exception):
 - (1) define “taxes” broadly to include state & local ROW fees, cable franchise fees and (possibly) PEG fees;
 - (2) lower all communications-related taxes to level of “general business” (and lower if communications-related fees are included in the calculus);
 - (3) eliminate local (as opposed to state) tax imposition, collection and enforcement; and
 - (4) continue to “wall off” the largest and fastest-growing segment of industry revenues (broadband) from taxation via the Internet Tax Freedom Act (“ITFA”).

Federal Communications Tax Legislation

- A.** Wireless Tax Fairness Act (HR-1002, passed the House; S.543, pending in Senate).
1. Would impose a 5-year moratorium on any new, or any increase in existing, state or local taxes on wireless services; would grandfather existing taxes.
 2. Note Lofgren “California” amendment to HR-1002: New taxes approved by voters are excepted. This sets dangerous precedent of Congress pressing its thumb on the scale of state government process in favor of taxation only by referendum, and raises potential constitutional (“republican form of government”) issues.

Wireless Tax Fairness Act (cont'd)

3. The bill is misguided in several respects:

- Prevents states and localities from revising tax policies to account for shift from landline to wireless.
- Has nothing to do with wireless broadband which is already protected by the ITFA.
- Singles out wireless industry for preferential treatment.
- Shifts transaction-based tax burden away from business and towards individuals and families.

Federal Communications Tax Legislation (cont'd)

Wireless Tax Fairness Act (cont'd)

- Damages our system of federalism.
- Is a solution in search of a problem—supposedly excessive taxes notwithstanding, wireless industry is growing by leaps and bounds.
- Based on misleading and inconsistent use of data—to suggest state and local wireless taxes are excessive, industry mixes state and local taxes with federal and state user, USF and PUC fees, yet then proceeds to exempt USF & FCC fees from the bill's reach.

B. The ITFA Problem.

1. Background.

- ITFA in effect since 1998, currently scheduled to expire in 2014.
- Pending bills to extend or make ITFA permanent: S.135; §2 of S.1934.
- Expect increased activity in next Congress (2013) as 2014 deadline approaches.

ITFA (cont'd)

2. ITFA is the elephant in the room in all communications tax debates.
 - Effectively “walls off” from state and local taxation the largest, and fastest growing, form of communications — broadband.
 - As what was formerly telecom is supplanted by broadband, states and locals are left with a shrinking communications service tax base. Left in place, the ITFA will eventually “tax exempt” all, or almost all, of the entire telecommunications industry’s services.
 - Unless telecom tax “reform” is coupled with ITFA repeal, industry will have no incentive to ever let ITFA expire.

Federal Communications Tax Legislation (cont'd)

C. The Digital Goods and Services Tax Fairness Act.

- 1.** HR 1860 and S.971, both pending.
- 2.** Would sharply restrict, and in many cases, preempt, the ability of state and local governments to tax “digital goods and services.” Examples include downloaded music and video, online photo storage, payroll processing and computer programs. In essence, the bill creates a nationwide “tax preference” for online goods and services over competing brick-and-mortar sales.

Digital Goods and Services Tax Bills (cont'd)

3. In addition, the bill would create a special problem for cable franchise fees. The bill would remove all pay-per-view (PPV) and video-on-demand (VoD) revenue from the cable franchise fee revenue base. It accomplishes this by (1) excluding only “video programming,” but not “cable service,” from the definition of “digital service,” (2) narrowing the “video programming” definition to exclude PPV and VoD services, & (3) prohibiting all “discriminatory taxes” on “digital services,” which means that the 5% cable franchise fee can’t be imposed on PPV or VoD services unless a locality imposes the same 5% fee on all digital & non-digital services, which of course most, if not all, localities do not &, by state or local law, cannot do.

D. Internet Sales/Use Tax Legislation.

1. House (pending).

- Marketplace Equity Act, HR 3179
- Main Street Fairness Act, HR 2701

2. Senate (pending).

- Marketplace Fairness Act, S.1832
- Main Street Fairness Act, S. 1452

Federal Communications Tax Legislation (cont'd)

Internet Sales/Use Tax Legislation (cont'd)

3. The details vary (and details matter), but all versions are intended to allow states and (to a lesser extent) local governments to collect sales and use taxes on remote (typically online) sales to their residents. The aim is to eliminate, or at least ameliorate, the current sales/use tax disadvantage suffered by brick-and-mortar retailers vis-à-vis online retailers, and to fill the current sales/use tax revenue gap for state and local governments created by burgeoning online sales.

Internet Sales/Use Tax Legislation (cont'd)

4. State and local governments, as well as brick-and-mortar retailers, have been seeking such legislation for years, and there are indications that momentum may be shifting in their favor.
5. But if relief comes, it will come at a price, especially for local governments. Most proposals would limit local tax-collecting authority vis-à-vis state tax-collecting authority.
6. *NOTE: Unlike other pending federal communications-related tax legislation, this legislation has a significant potential upside: it offers local governments the opportunity to expand their local sales/use tax base (assuming increased tax proceeds are passed on to locals).*

State Communications Tax Reform

- A. Several states, at industry's behest and in varying forms, have enacted communications tax "reform."
 - 1. Examples include VA, FL, KY, OH, and NC.
 - 2. MTC proposals regarding communications tax centralized administration.

- B. Details vary, but the basic approach is to:
 - 1. Collapse all communications-related taxes and fees (cable franchise fees, perhaps PEG fees, DBS, landline telecom & wireless) into a single tax.
 - 2. Move responsibility for imposition, collection and auditing of the tax to the state level.

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3. Some or all of the proceeds are remitted by the state to localities.
4. Note: Effect is to eliminate communications-related ROW fees, effectively reducing communications-related ROW compensation to zero—a boon/subsidy to landline providers.

C. Supposed “carrots” for local governments:

1. Expand tax base, especially with respect to DBS, which FTA only allows states to tax.
2. Reduce or eliminate local governments’ cost of administering, enforcing and auditing communications taxes and fees.
3. Lower tax rate, but with expanded tax base, will ostensibly make local governments whole in a tax revenue sense (although usually only on a “snapshot” basis).

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D. Benefits for industry:

1. Lower tax administration costs.
2. Lower taxes, except perhaps for DBS.
3. Greater protection against future tax increases.

E. Risks to local governments:

1. Loss of ability to control local tax structure and policy, and thus control over local budget revenues.
2. Loss of auditing authority to ensure correct amounts are paid. If state simply remits proceeds to localities, it has no incentive to spend resources to audit or enforce the tax because it gains no revenue from such actions.

State Communications Tax Reform (cont'd)

(cont'd)

3. The risk that, in tough budget times, the state will decide to keep some or all of the tax proceeds for itself.
4. The risk of sweeping PEG fees into the definition of “tax,” which could mean that even if the new tax is intended to be revenue neutral, it won’t be for locals relying on PEG fees.
5. The narrowing of the potential communications tax base in the state law’s definition of taxable “communications services” (e.g., the “*Dallas*” issue) that would likely mean less tax proceeds, with the loss accelerating in future years.

State Communications Tax Reform (cont'd)

(cont'd)

6. The sizable risk (based on analogous experiences in TX, KY & FL) that the setting of a supposedly “revenue neutral” state tax rate will at best result only in “snapshot” revenue neutrality, but in significant tax revenue losses (or cutting off the growth of tax revenues) in the out years.
7. If ROW compensation fees are eliminated & rolled into a general tax, the ITFA exemption for ROW fees is lost.
8. Makes no sense to consider or enact communications tax “reform” without eliminating ITFA. Otherwise, you’re just locking states and locals into perpetually shrinking communications tax base, violating the cardinal rule of tax policy to expand tax base to “like” services, not shrink it.

Concluding Thoughts

- ▶ Local governments' future ability to tax or impose fees on any type of communications service provider is at serious risk.
- ▶ Communications tax “reform” at the federal or state level is a very dangerous game for local governments and their future ability to control their own tax policy and tax revenues. They, not states or industry, have the most to lose, the least to gain.
- ▶ That doesn't mean that communications tax reform has to be bad for local governments, and it may be inevitable. But it does mean that locals need to be far more active participants in the reform process than they have been to date.
- ▶ Until or unless the ITFA is repealed or allowed to expire, meaningful communications tax “reform” is simply an industry tax reduction exercise, not true tax reform.



Questions?

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