

Taxing Telecommunications



FTA Revenue Estimating and Tax Research Conference

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Overview

- Review issues and factors challenging current state and local taxation of telecommunications.
- Discuss importance of telecommunications tax reform.
- Describe possible solutions and current reform efforts.



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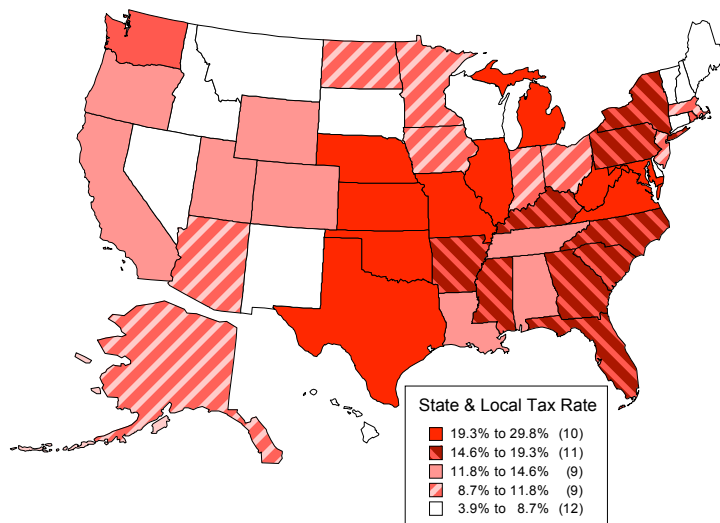
Issues and factors challenging current state and local taxation of telecommunications

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Highlights COST Study



2004 COST 50 State Study and Report on
Telecommunications Taxes

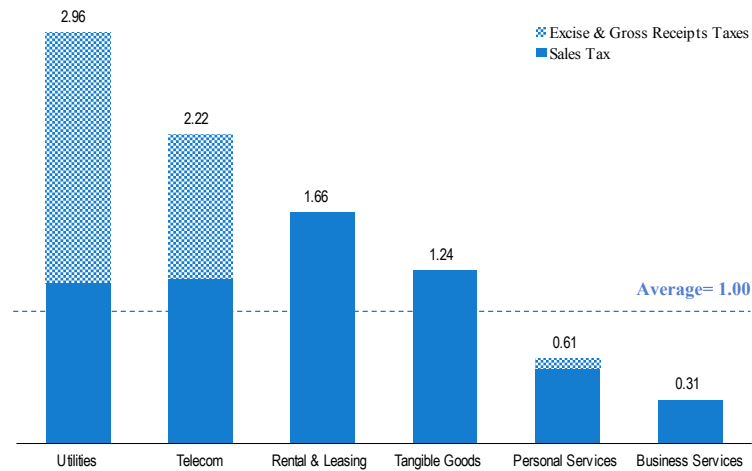
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Transaction Tax Burden on All Sales

Multiple of Average Transaction Tax Rate



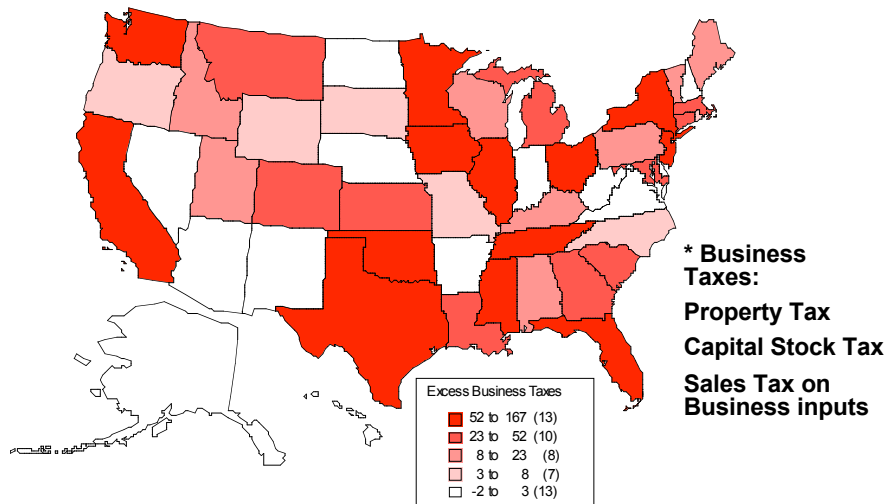
Source: Ernst & Young, Total State and Local Taxes Paid by the Telecommunications Industry, Fiscal year 2004

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Excess *Business Taxes



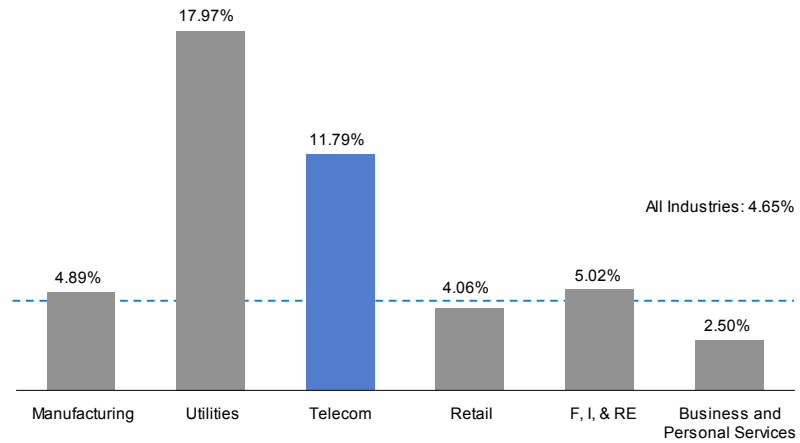
Source: Ernst & Young, Telecommunications Taxes: 50-State Estimates of Excess State and Local Tax Burden, November 2001

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Total State and Local Effective Business Tax Rates on Value Added by Industry, FY2004



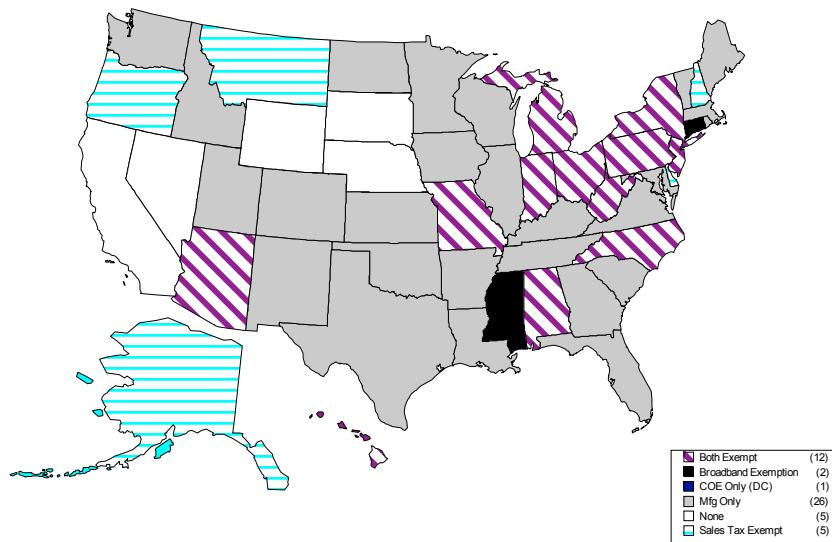
Source: Ernst & Young, Total State and Local Taxes Paid by the Telecommunications Industry, Fiscal year 2004

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Equipment Exemptions



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Highlights COST Study

	<u>Gen. Bus.</u>	<u>Telco</u>
# Tax Returns Filed per Year	7,501	47,921
# of Taxes to Administer	123	344
# of Jurisdictions	7,196	13,879
Average Tax Rate	6.12%	14.17%

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Telecommunications Trends

- Wireline

- ✓ In 2003, switched services accounted for 60% of wholesale wireline revenue, and in 2008, Yankee group forecasts that they will generate approximately 48% of the total U.S. domestic wholesale service revenue (Yankee Group, October 2004)
- ✓ "Wholesale switched access service have suffered steady declines." (Yankee Group, October 2004)
- ✓ According to FCC Trends in Telecommunications U.S. Wireline switched access lines decreased from 192.5 million in 2000 to 183 million in 2003
- ✓ Although the demand for wholesale voice services is declining, it is being offset by the growth in data services and wholesale IP connectivity, the fastest growing segment. (Yankee Group, July 2004)

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Telecommunications Trends

- VoIP

- ✓ Voice over Internet Protocol (VoIP) is finally coming of age for the enterprise. According to this new research from Deloitte, it is forecast that more than two-thirds of the Fortune 2,000, will have deployed VoIP either partially or wholly by 2006.
- ✓ ABI Research's latest study of residential VoIP concludes that the subscriber base of Voice over IP (Internet Protocol) services worldwide will remain small compared to the numbers of conventional fixed and mobile phone customers, even by 2010. But in terms of relative growth, VoIP is - and will remain - a dynamic market.
- ✓ A Yankee Group study concludes that wholesale providers have reached an inflection point and are facing a significant gap in legacy services revenue. The revenue gap is growing wider as wholesale buyers continue to migrate from formerly high demand transport services.

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Telecommunications Trends

- Wireless

- ✓ From FCC (Trends in Telephone Service)
 - ✓ the number of wireless subscribers grew from 80 million at the end of 1999 to 170 million subscribers as of June 30, 2004
 - ✓ The average monthly bill increased from \$41 at the end of 1999 to \$49 s of June 30, 2004.
 - ✓ Interstate wireless minutes increased from 16% of total minutes in 2000 to 26% of total minutes in 2003

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Bundling

- How do you determine the tax when the bundle includes taxable and non-taxable components?
 - Solution:

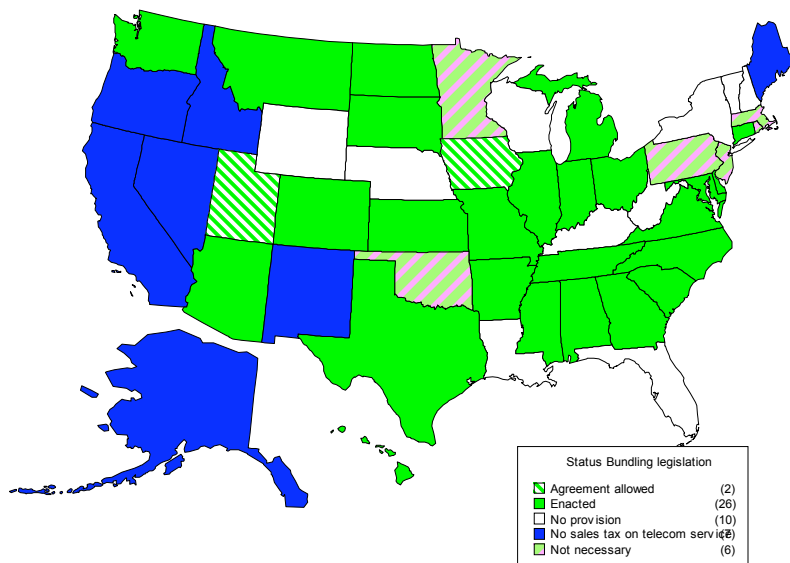
Provide for taxation only of the taxable portion of the bundle in accordance with the State's policy choices. Adopted by Streamlined Sales Tax Implementing States April 2005

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Bundling Legislation



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What is VoIP?

- ▶ Voice over Internet Protocol is both a technology and a service.
 - The technology is Internet protocol that enables packet transmission over data networks.
 - The service is voice transmission. Voice over IP enables new services to be created.
- ▶ Currently there are two common methods for broadband IP telephony:
 - Hosted applications: the service operates independently of the access network (AT&T *CallVantage* and Verizon *VoiceWing*)
 - PacketCable: the service is interlocked with the access network (Digital Phone Service from Comcast and Time Warner)

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Current State and Local Tax Treatment of VoIP

- State and local definitions of taxable telecommunications are broad and do not necessarily follow FCC or State regulatory definitions.
- State and local tax definitions of telecommunications include transmission of voice and data regardless of media or protocol.
- Sample statutes:
 - “Or other medium or method now in existence or hereafter devised, regardless of the protocol used for such transmission or conveyance.”
 - “. . . and Internet telephony.”
 - “The transport over the Internet or any proprietary network using the Internet protocol of telephone calls...”

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Recent Rulings

- **Illinois – Letter Ruling - ST 05-0008-GIL**
 - VoIP is telecommunications subject to tax.
- **Massachusetts – TIR 0-8**
 - Includes VoIP in taxable telecommunications
- **Minnesota – Revenue Notice – 05-03**
 - VoIP is a telecommunications service.
- **New Jersey – Notice – 2/23/2005**
 - VoIP is subject to the sales tax and the 911 tax.
- **Pennsylvania - Sales Tax Bulletin 2005-02**
 - VoIP is a telecommunications service subject to state and local sales tax.
- **Wisconsin - Tax Bulletin No. 141 (Jan. 05)**
 - Sales tax applies to VoIP.

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Recent Legislation

- **Arkansas – 2005 Act 1879**
 - Telecommunications services includes VOIP.
- **Florida – SB 2070 (2005)**
 - Includes transmission without regard to label as VoIP.
- **Tennessee – Chapter 499 Laws of 2005**
 - Adopts the Streamlined Sales Tax definition of telecommunications

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What are some of the State and Local tax issues with VoIP?

- Does the state or local taxing authority have sufficient “nexus” with many of the providers of VoIP?
 - Web site of one early VoIP provider:
“(Do you live in New Jersey? New Jersey is a nice place to live and since we are headquartered here we must charge sales tax for New Jersey residents.)”
- What jurisdiction has the right to tax the charge for VoIP service?
 - Streamlined Sales Tax Agreement Sourcing Rule:
a sale of telecommunications services sold on a basis other than a call-by-call basis, is sourced to the customer's place of primary use.
- Is the Tax Statute out-of-date?
 - Old definitions, distinctions based on who is the provider, and lack of clear sourcing rules
- Does the Internet Nondiscrimination Act apply?
 - The Act provides that it has no impact on the taxation of VoIP.

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Importance of telecommunications tax reform.

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Why is Reform Needed?

- Telecommunications infrastructure is the backbone of the Internet, and a vital part of the new economy.
- Discriminatory property taxes and lack of equipment exemptions increase the cost of deploying the infrastructure.
- Taxes on customers and providers increase prices, lower demand, and reduce funds available for capital investment.
- High taxes slows broadband deployment and delays productivity benefits to consumers and businesses, especially in rural / underserved areas

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Telephone Service is not a luxury.
Since 1970, over 90% of HH have telephones...

Table 16.4
Historical Telephone Penetration Estimates

Year	Percentage of Households with Telephones	Access Lines per 100 Population
1920	35.0 %	9.6
1930	40.9	12.5
1940	36.9	12.7
1950	61.8	21.7
1960	78.3	27.6
1970	90.5	35.0
1980	92.9	44.8
1990	94.8	54.3
2000	97.6	66.4

It is essential infrastructure for businesses and consumers.

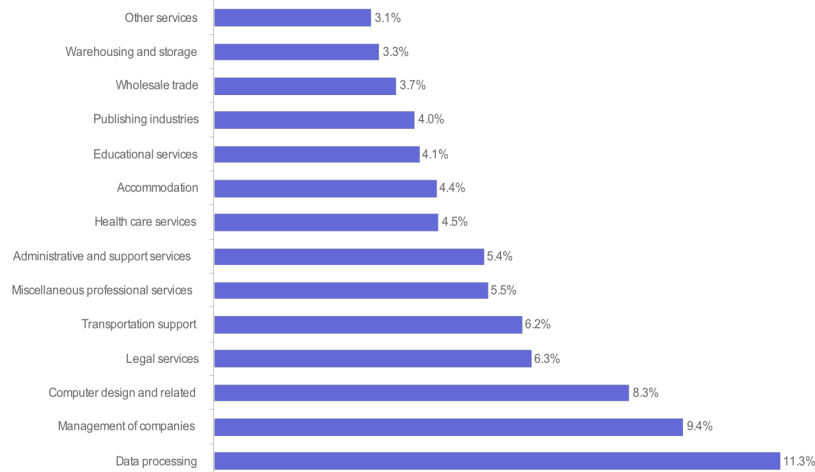
Source: See *Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, April 2005, Table 16.4
Lehr 2005

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Telecom Services as a Percentage of Total Business Input Purchases



Source: U.S. Bureau of Economic

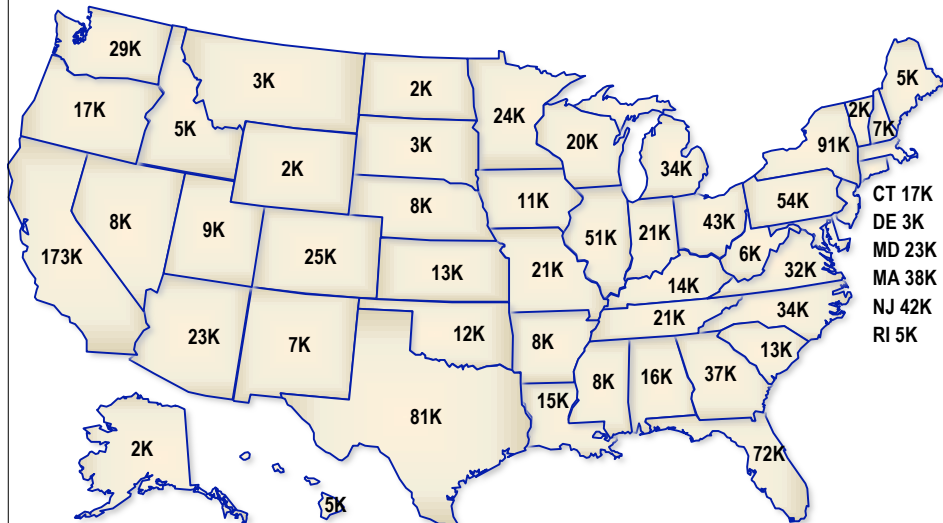
Analysis
Source: Ernst & Young, Total State and Local Taxes Paid by the Telecommunications Industry, Fiscal year 2004



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1.2 Million New Jobs with Wide-Spread Broadband Deployment



State Economies Can Benefit from Broadband Deployment, Wayne T. Brough, PhD Chief Economist at CSE Freedom Works Foundation, Report Issued 12/17/03, Appendix: "Jobs and Output Due to Widespread Broadband Deployment" - (pg 20), www.cse.org/reports/Broadband_Study.pdf

Site Location Decisions

Survey Rankings by Site Location Professionals

(1 = not very important ... 3 = very important)

➤ Availability of skilled labor	2.84
➤ Easy access to transportation	2.74
➤ Telecommunications capacity	2.72
➤ Availability of trainable labor	2.70
➤ Availability and attractiveness of local and state tax incentives	2.61
➤ Assistance from state agencies	2.51
➤ Proximity to customers	2.41
➤ Local government assistance in establishing operation	2.40

Source:
Georgia State University,
Fiscal Research Program,
*Firm Location Decisions and
Information Needs*
FRC Report #93, March 2004

Possible solutions

What Can Be Done?

- Eliminate discriminatory taxes—i.e. permitted to tax telecom as general business is taxed
 - Exception for certain fees where revenue funds the specified purpose.
- Modernize the definition of telecommunications to provide clarity and certainty.
- Remove excess tax burden on the deployment of telecommunications property and equipment.
- Enact bundling legislation to ensure that tax exempt services remain exempt.

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Big Seven Effort

- Participants represent a broad range of organizations representing various levels of government and segments of the communication sector
- All participants put forward principles for reform of telecommunications and elimination of discriminatory taxes.
- Straw man proposal was giving to the group.
- Biggest difference is between local governments and other participants.

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Summary

- Throughout most of the country, telecommunications companies and their customers face greater state and local tax burdens than general business companies and their customers.
- These outmoded and discriminatory taxes stem from an era when the telephone company held a monopoly -- an approach that makes no sense in today's highly dynamic environment.
- The introduction of VoIP offers an opportunity to eliminate outdated tax burdens and the discriminatory taxation of telecommunications service and providers -- not to extend them and increase the discrimination.

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Thank You!

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