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Written Testimony of
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Senator Krueger and Members of the Select Committee, thank you for the opportunity to join the Committee for a roundtable discussion on "Modernizing New York State's Telecommunications Taxes."

My name is Scott Mackey and I am an economist and partner at Kimbell Sherman Ellis LLP in Montpelier, Vermont. I have been working for the past nine years with a national coalition of wireless carriers to promote state and local tax policies that encourage investment in communications networks and eliminate discriminatory taxes on wireless consumers. This coalition includes AT&T, Sprint, T-Mobile USA, US Cellular, and Verizon Wireless. I've published two studies comparing the tax and fee burden on wireless consumers in the states, both published in *State Tax Notes*. (I've attached the most recent of these studies as an Appendix.)

Prior to joining KSE, I was Chief Economist at the National Conference of State Legislatures (NCSL) in Denver, Colorado. I staffed NCSL's Task Force on Taxation of Telecommunications and Electronic Commerce and served as the NCSL representative to the federal Advisory Commission on Electronic Commerce. While at NCSL, I helped develop the NCSL policy supporting state and local communications tax reform that was first adopted in July 2000 and is still the official policy of NCSL today. It is attached as an Appendix.

Today I want to focus on the two primary reasons why I believe that New York desperately needs to modernize its communications tax system. First, tax policy plays an important and growing role in decisions about how and where to invest in communications networks. As broadband networks become even more vital to economic growth, it becomes more critical that state and local tax policies encourage private sector investment in broadband networks. Second, the tax burden on New York communications customers is excessive and out of line with neighboring states. These high taxes have important implications for the ability of communications companies to invest in New York, but they are also unfair to low and moderate-income New Yorkers.

The Economic Value of Broadband Investment

Governments at all levels now recognize that investment in broadband networks will play an important role in both the short-term recovery from the current recession, as well as long-term economic growth. A number of new studies from economists across the political spectrum show that broadband networks boost productivity and economic growth by enabling businesses and governments to be more efficient.[1] This is one reason that the federal stimulus package included funds for broadband investments, and why most states are seeking ways to stimulate broadband investment.

Last year the telecommunications industry invested an estimated $50 billion in communications networks, dwarfing the $7 billion included in the federal stimulus bill.[2] Given the exploding federal deficit and the budgetary problems facing the states, it is unlikely that new direct spending by federal and state governments will come anywhere close to the investments that the private sector is currently making in broadband networks.

Therefore, the work of this Select Committee is very timely. An overhaul of the entire New York state and local tax system can improve New York's ability to attract new investment in communications networks that will make New York's economy more productive and create new jobs.

How State and Local Taxes Impact Communications Network Investments

State and local taxes are one of a number of factors that determine where and how communications companies invest in communications networks, and there are two primary ways that direct taxes on companies impact investment. First, taxes on the income of communications providers reduce the amount of after-tax income available for investment. This "free cash flow" or "cash flow from operations" is a particularly important source of investment funding in light of the recent uncertainty in the capital markets.

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[1] See testimony from Dr. Robert D. Atkinson, President, Information Technology and Innovation Foundation, before US House Judiciary Committee, Subcommittee on Commercial and Administrative Law, June 9, 2009.

[2] Larry Darby and Joseph Fuhr, "To Spread Broadband, $7.2 Billion Isn't Enough," *Business Week*, August 3, 2009.

Second, state and local taxes impose taxes directly on the capital equipment deployed in communications networks. Sales and use taxes on network equipment add to up-front cost of the equipment, while property taxes are imposed on the value of network equipment. Both types of taxes increase the cost of investment and lower the rate of return on specific investments and can influence which investments are made in a given states.

To promote investment, purchases of network equipment should be exempt from state and local sales taxes. It is commonly recognized by tax experts and economists that sales and use taxes should be imposed on final consumption and not on inputs to the production process. New York currently exempts equipment used to provide telecommunications service and Internet access, a policy that has helped attract investment in New York and should be continued in any tax reform proposal. The committee may want to review the language of this exemption to ensure that it incorporates all types of technologies used in communications networks, both today and in the future.

For property tax purposes, New York currently does not tax personal property. However, certain network infrastructure necessary to provide communications service is considered real property and subject to property taxes, while the value of certain franchises is also considered real property. This tax treatment increases the ongoing cost of deploying network infrastructure in New York, lowering the rate of return on such investments. The committee may want to undertake a comprehensive review of property tax treatment of the network infrastructure of communications providers.

Excessive Taxes in New York are Unfair to Consumers

New York has very high taxes on consumers of communications services. For example, New York has the fourth highest state and local tax burden in the country on wireless service, with an effective rate of about 16 percent on the typical consumer’s bill. A consumer purchasing a taxable good or service subject to the sales and use tax would pay, on average around 8 percent.

Taxes on communications services are regressive, requiring low and moderate-income consumers to pay a significantly higher share of their incomes on communications services than higher income consumers. The current recession is forcing many low- and moderate-income households to cut expenditures on communications services, and taxes no doubt play a role in these decisions. For example, there has been an accelerating trend toward "wireless-only" households since the start of the recession.

Recent studies by the Centers for Disease Control found that low-income households are hit hard by wireless taxes. For example, 27% of households in poverty have wireless service as their only telecommunications service and 59% of "wireless only" households have incomes below $40,000 per year.[3]

Many states use tax policy to discourage behavior that is perceived as socially unacceptable or unhealthy. For example, states impose high taxes on cigarettes in order to discourage smoking. In the case of communications services, however, the educational and economic benefits of communications service are well documented. At a minimum, tax policy should not punish users of such services with excessive and regressive taxes.

In addition to placing an unfair burden on consumers, taxes on communications services also have an indirect impact on infrastructure investment. This is simple economics – the higher the price, the lower the purchases of the good or service. Economists measure consumer responses to changes in demand as the "price elasticity of demand." For example, the most recent econometric studies estimate that the elasticity of demand for wireless service is about -1.2. This means that for every one percent increase in the price of service, consumers will reduce purchases by about 1.2%.

These high tax rates mean that consumers are spending less than they otherwise would on service if the taxes were closer to the rates imposed on general purchases of taxable goods and services under the sales tax. Lower purchases from New York customers reduce the amount of "cash flow from operations" that is available to invest in communications networks.

[3] Blumberg, Steven J. and Julian V. Luke. "Wireless Substitution: Early Release of Estimates from the National Institutes of Health Interview Survey, July – December 2007." Atlanta: Centers for Disease Control (CDC), May 13, 2008.

Reform Principles

One of the reasons why the New York state and local communications tax structure has become complex and outdated is the piecemeal approach that has been adopted in the past. Taxes and fees have been added to services in response to specific state or local revenue needs without a full examination of the cumulative impact of these taxes on the providers or consumers.

Many of these taxes originated during the era when telephone service was a regulated monopoly. As the industry was deregulated, and as new technologies and competitors entered the marketplace, the Legislature attempted to "level the playing field" by expanding monopoly-era taxes to newer technologies.

In order to avoid this problem going forward, it is important that the Legislature look at the entire tax structure as a whole, including both state and local taxes and fees. Such an overhaul will likely have ramifications for the state, cities, counties, and some special taxing authorities. Therefore, it is important that a process be set up to consider the impacts on these stakeholders and to try to achieve consensus.

Finally, it may be helpful to consider using the NCSL Communications Service Tax Reform principles to guide the state's reform effort. These principles were developed by a bipartisan group of legislators from across the country. While there is no "one size fits all" approach to tax reform that works in all states, these principles can help guide the New York reform effort.

New York has an opportunity to build on the current strengths of its tax structure – the exemption of network investments from the sales and use tax – and to overhaul and address the burden of both multiple levels of taxation and high consumer taxes. As part of this review, New York should also continue its practice of being open to new and unique alternatives and approaches to meeting the policy objectives of broad-based communications reform. Taking these steps will leave the state well positioned to enjoy the economic benefits of robust broadband networks in the coming decades.

Thanks again for the opportunity to participate today.

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

COMMUNICATIONS TAX REFORM

EXECUTIVE COMMITTEE TASK FORCE ON STATE AND LOCAL TAXATION OF TELECOMMUNICATIONS AND ELECTRONIC COMMERCE

WHEREAS, until 1984, telephone service was a highly regulated service generally subject to tax under statutes applicable to "public utilities"; and

WHEREAS, such taxes in the form of gross receipts, franchise and other industry-specific taxes were passed on to consumers as part of the regulatory rate setting process; and

WHEREAS, convergence and technology have radically expanded communication services, blurring distinctions between telephone and Internet service in some instances; between cable, wireless, satellite, and wireline; between long distance and local service and between telephone and other forms of communications and information services;

WHEREAS, the elimination of boundaries, new technologies and increased convergence and competition in the communications industry makes it critical to simplify and reform state and local taxes to ensure a level playing field, to enhance economic development, and to avoid discrimination; and

WHEREAS, the combination of state and local taxes and fees imposes significant administrative costs on communications companies, most of which operate in multiple states and localities, and offer multiple services through a variety of technologies; and

WHEREAS, this administrative burden forces such companies to incur substantial expenditures to satisfy compliance and systems requirements, resulting in higher costs of service for consumers without any corresponding benefit to state or local governments; and

WHEREAS, state and local tax burdens on communications companies and their customers are significantly above those imposed on most other types of industries and services; and

WHEREAS, taxes on communications services are regressive, applying a discriminatory tax regime to communications services, only adds to the "High Cost of Being Poor" for low income Americans; and

WHEREAS, many government officials have worked to develop programs that bridge the so-called "digital divide," only to raise taxes on those very same communications services that may be three to five times higher than the general sales tax, thus punishing the people they are trying to assist; and

WHEREAS, a recent study by the Heartland Institute shows that the average American household would save approximately $125.76 a year if taxes on communications services were no higher than the general sales tax; and

WHEREAS, imposing these higher tax burdens on communication services provided by some telecommunications and communications providers while imposing lower and even no tax burdens on similar services sold by non-traditional providers places governments in the position of picking winners and losers in the marketplace; and

WHEREAS, enhanced access to advanced communication services provides important economic, safety, and social benefits to citizens and businesses in the new, global economy; and

WHEREAS, high administrative costs and tax burdens imposed on the communication service industry create an impediment to entry for new service providers, disincentives to deploy infrastructure and increase the cost to consumers of access to advanced communications services.

NOW, THEREFORE BE IT RESOLVED THAT, the National Conference of State Legislatures encourages states to work together with local governments and providers in their efforts to simplify and modernize state and local taxes on communication services based upon the following principles:

1) **Tax Efficiency:** State and local 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.
2) **Competitive Neutrality:** State and local transaction taxes and fees imposed on communications services should be applied uniformly and in a competitively neutral manner upon all providers of communication services, without regard to the historic classification or regulatory treatment of the entity.
3) **Tax Equity:** Under a uniform, competitively neutral system, industry-specific telecommunications taxes are no longer justified.
4) **Tax Fairness:** With the blurring of distinctions between various services and technologies, state and local governments must strive to set tax burdens on communications services, property and providers that are no greater than those tax burdens imposed on other competitive services and the general business community.

5) **Local Government Impacts**: States need to include provisions to mitigate potential local government revenue impacts associated with communication tax reform.
6) **Economic Development:** States need to simplify, reform and modernize state and local telecommunications tax systems to foster competition, encourage economic development, reduce impediments to entry, and ensure access to advanced communications infrastructure and services throughout the states.
7) **State Sovereignty:** NCSL will continue to oppose any federal action, other than prohibition of taxes on Internet access, or oversight role which preempts the sovereign and Constitutional right of the states to determine their own tax policies in all areas, including telecommunications and communication services.

Unanimously adopted by the NCSL Executive Committee Task Force on State and Local Taxation of Telecommunications and Electronic Commerce on Sunday, August 5, 2007.

Unanimously adopted by the NCSL Executive Committee on Monday, August 6, 2007.