



Issue Analysis

Communications Tax Reform: Emerging Technologies that Promote Investment and Customer Choice

By Eric Tresh

Communications service providers offer voice, video and Internet access services to customers throughout Georgia. These services are provided by a number of different types of companies using a variety of broadband technologies.

For example, telecommunications, satellite and Internet companies now offer video programming service. In addition, cable providers often have subsidiaries that provide voice services and a number of companies use the Internet to provide audio and video conferencing services. These services all benefit consumers and enhance productivity throughout the state.

In addition to the benefits for consumers, broadband services are significant drivers of Georgia's economy. Broadband providers invest hundreds of millions of dollars each year into Georgia's economy, creating jobs and enhancing infrastructure.

While technology has expanded rapidly, the state's legal framework has been slower to catch up, especially in the area of tax policy.

Georgia's current tax structure provides preferential tax treatment to some providers based solely on the type of infrastructure they use to deliver the product. For example, some video service providers such as cable and telephone companies pay franchise fees of approximately 5 percent of their gross video service charges. Functionally equivalent satellite service providers do not pay any state or local taxes or fees on their service.

Another example of outdated tax policy related to broadband deployment relates to sales and use tax exemptions on broadband investment in the state. Georgia, like many states, exempts manufacturers' purchase of equipment from state and local sales and use tax. The reason for this exemption is twofold: It facilitates capital equipment investment in the state and exemplifies sound tax policy by exempting sales inputs while imposing tax on end-user consumption.

Unfortunately, this sound tax policy is not reflected in Georgia's taxation of many communications services. Georgia's communications service providers are required to pay state and local sales and use taxes on the vast majority of their capital equipment purchases, while many of their services are subject to state and local taxes and fees. As a result, Georgia's communications service providers and consumers are in effect taxed twice – once on the inputs used to produce their service and again on the sale to end-user consumers. This double taxation runs afoul of sound tax policy.

Several states and the federal government have recognized that broadband service is the key to economic development in the 21st century. High-speed broadband service removes geographical barriers to global marketplaces and facilitates the development of nearly all of today's start-up businesses. Notwithstanding the proven economic benefits of enhancing broadband deployment through tax reform,

some of Georgia's broadband service providers are subject to higher tax and fee burdens than competitors that offer functionally equivalent services. To remedy this problem, Georgia should consider communications tax reform by crafting a broader, fairer and more equitable tax regime that reduces consumer and business costs for broadband deployment and communications services.

Not All Georgia Communications Service Providers Are Treated Equally

Two fundamental tenets of sound communications service tax policy are: (1) Consumers should be provided with a tax-neutral choice and (2) Functionally equivalent services should be taxed in a similar manner. These tax policy tenets help to ensure that communications service providers compete on a level playing field and that consumers are able to choose their service provider without regard to taxes. Georgia's current tax and fee system does not adhere to these tax policy tenets.

Many different communications service providers operate in Georgia today, each paying a variety of different taxes and fees on the equipment used to provide their services and on the sale of their services to consumers. In addition to traditional cable television service providers and telecommunications providers, there are a number of relatively new entrants to Georgia's voice, video and Internet markets. Companies with little or no investment in the state's infrastructure compete with traditional telephone and cable companies by providing voice and video service over the Internet and through wireless service. Yet the state and local taxes and fees paid by these competing service providers can differ significantly. These differences distort the communications services marketplace and impact investment and consumer choice.

The Importance of Functional Equivalence

When evaluating communications tax and fee reform, functionally equivalent services should be subject to similar taxes. While it is often easy to consider all communications services together under the commonly-used veil of "convergence," it is important to note that there are actually three separate and distinct markets: the market for voice or telecommunications services, the market for video services, and the market for Internet access services. Video programming services should be subject to the same taxes and fees no matter which provider sells the video service, and without regard to how that video service is delivered. Likewise, a telephone call from Atlanta to Macon should be subject to the same taxes and fees whether the call is made using a traditional landline, a wireless device or the Internet.

Internet service itself (as distinguished from the purchase of content or voice services via the Internet), of course, remains exempt from state and local tax; state and local governments are prohibited from enacting multiple and discriminatory taxes on electronic commerce in general as a result of the Federal Internet Tax Freedom Act (ITFA). ITFA is a good example of sound tax policy designed to facilitate broadband deployment and ensure that state and local governments do not pick winners and losers by imposing higher tax burdens on some providers than on others.

Following by Example – Other States' Reform

Over the past several years, a number of states have reviewed their tax policies with respect to communications services. Several states have taken the first step to enact legislation which ensures that functionally equivalent services are taxed in a similar manner thereby offering consumers a tax-neutral choice of service providers. Policy-makers have also considered the differences in the historic tax and regulatory treatment of video and telecommunications service providers. Indeed, tax reform cannot and should not take place in a vacuum by evaluating only portions of the competitive landscape.

Specific Examples of State Communications Services Tax Reform

Many states have amended their statutes to address disparate treatment of cable, other video and direct broadcast satellite service providers. These include Virginia, North Carolina, Delaware, Kentucky,

Massachusetts, Ohio, Florida and Tennessee. However, two states can be looked to as examples of states that have approached reform in a broader way. In 2005, North Carolina established a telecommunications sales tax of 7 percent on video and communications services and eliminated local franchise fees.^[1] The sales tax is collected from purchasers by video and communications service providers and remitted to the State. The State then allocates a portion of the tax collections to local governments. North Carolina also provides an exemption from the sales tax for equipment used to provide communications services (voice, video and Internet access service), thus avoiding pyramiding of the sales tax. North Carolina provides a good example of a communications tax system that eliminates anti-competitive tax disparities and encourages broadband infrastructure investment.

Virginia reformed its state communications tax policy in 2007, implementing a new communications services tax (CST) in lieu of myriad state and local taxes and fees previously imposed on communications service providers. Virginia's CST, like North Carolina, is imposed on the customer and vests the imposition and administration of the tax with the state Department of Taxation.

The Best – and Simplest – Solution

Any communications services tax reform should ensure that functionally equivalent services are taxed similarly. Sound tax policy does not dictate that video, voice or Internet access services be taxed identically but, rather, that a fair and administrable tax system exists that promotes growth for all market entrants. The best – and simplest – solution that would achieve these goals and update Georgia's communications services tax regime is a state-level communications services tax and a reformed fee system. Georgia has the opportunity to take what has worked in other states and become a model state for communications tax reform. The North Carolina model, in particular, presents an effective, real-life example of tax reform that exempts communications equipment, promoting broadband investment by video, wireless and telecommunications providers throughout the state. Virginia's CST provides the uniform retail sales tax model that treats the sale of all communications services the same as the sale of other retail goods and services. Georgia policy-makers would be well served by studying the reform measures enacted by these states as potential models for communications services tax reform. Eliminating the discrepancies that have developed in our tax system through comprehensive reform will encourage investment in Georgia, provide a level playing field for competitors in today's new communications marketplace, and benefit the state's consumers by enhancing choice.

[1] North Carolina recently increased its rate to 8 percent.

This Issue Analysis was written for the Georgia Public Policy Foundation by Eric Tresh, a Partner at Sutherland Asbill & Brennan LLP who is an expert on state and local tax matters. The Georgia Public Policy Foundation is an independent think tank that proposes practical, market-oriented approaches to public policy to improve the lives of Georgians. Nothing written here is to be construed as necessarily reflecting the views of the Georgia Public Policy Foundation or as an attempt to aid or hinder the passage of any bill before the U.S. Congress or the Georgia Legislature.

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