A Study by the TTARA Research Foundation

THE TELECOMMUNICATIONS INDUSTRY

IN THE

TEXAS ECONOMY AND TAX SYSTEM

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EXECUTIVE SUMMARY

The telecommunications industry plays a vital role in the Texas economy by providing a service – the transmittal of information by voice or data transfer – that is essential to the transaction of business. In addition, the industry itself is a major contributor to state economic output, employing more than 100,000 highly-paid workers and generating more than $21 billion in revenues. Economic models estimate that increases in demand for telecommunications services significantly impact the Texas economy and that every new telecommunications job creates about five additional jobs.

Taxation of the telecommunications industry in Texas dates back to the early 1900s with the adoption of a telephone company gross receipts tax. Over the past century, numerous changes to the array of taxes on the telecommunications industry and on consumers of telecommunications services has produced the current complement of four consumer taxes and five industry levies, increasing the cost of purchasing telecommunications services by more than one-fourth and making it very difficult for consumers to discern exactly what is being taxed and at what level. In addition to these industry-specific taxes, all other state and local taxes that apply to businesses generally – such as sales, corporation franchise and property taxes – in like measure also apply to the telecommunications industry.

The pattern of telecommunications taxation developed during the time that the industry was considered a "natural monopoly" and was rate-regulated, allowing for industry taxes to be passed on to consumers as a hidden part of the rates charged for service. Today, telecommunications is vastly different due to growing competition in service provision, the rapid pace of technological advances and the blurring of lines between industry segments. Despite this reality, the complicated scheme of telephone taxation developed in the much different past remains in place. Texas is not alone in this respect, as most other states are in a similar situation. However, there have been calls nationally for telecommunications tax reform to harmonize tax policy with two main goals of telecommunications policy – lowering the cost of service by expanding market competition and fostering access to high-speed, broadband service.

There has been some recognition by Texas policy makers of the mismatch between the state's tax policy and its developmental goals for the telecommunications industry, and some recent changes have been made primarily to reduce provider compliance costs and to encourage greater competition by lowering operational costs for new market entrants. Given the rapid technological change and growing competition in the industry, a careful examination of the potential benefits to be gained from tax simplification, reduction, and efficiency is in order.

To shed light on the issue, the TTARA Research Foundation undertook this study to provide background information about the telecommunications industry and its taxation.

CONTENTS

FIGURES

THE TELECOMMUNICATIONS INDUSTRY IN THE TEXAS ECONOMY AND TAX SYSTEM

In Texas, as shown in a national study, state and local taxes can add more than one-fourth to the cost of purchasing telecommunications services depending on the type of service provider. With federal taxes added, almost one-third of the telephone bills of Texas consumers goes to pay government taxes or fees. This comes as no surprise to anyone who has taken the time to closely examine their monthly phone bill. However, the application of multiple taxes at varying rates on different portions of the charges for phone service makes it very difficult, if not impossible as a practical matter for most consumers to figure out exactly what is being taxed and at what level.

Some taxes are imposed directly on consumers and some are levied on the telephone company. Some are levied for general revenue purposes, some to offset the cost of regulation of the industry, and some to finance specific government programs. The result is not only significantly higher prices for consumers, compared to the added costs resulting from taxes generally imposed on purchases of other goods and services, but increased tax compliance costs for telecommunications service providers.

The following discussion begins with a profile of the Texas telecommunications industry, a major component of the state's economy, followed by a discussion of the taxes and fees, including significant aspects of associated tax policy and administration issues, that apply to telecommunications providers and to the purchase of telecommunications services by Texas consumers.

TEXAS TELECOMMUNICATIONS INDUSTRY PROFILE

The telecommunications industry plays a vital role in the Texas economy. The ability to transmit information by voice or data transfer which it provides is essential to the transaction of business in virtually all industries. And today, access to advanced telecommunications services and information technology is fundamental to the state and nation's entire economy and is critical to its future growth.

The industry is comprised of a range of different providers delivering services in multiple ways, including via traditional wirelines, wireless and the Internet. The rapid pace of technological advancement in the industry has promoted the ongoing convergence of voice and data transmissions technologies and the rapid expansion of access to enhanced services. The advent of competition, begun in long-distance service in 1984 with the breakup of AT&T and in local exchange markets in 1996 with passage of the federal Telecommunications Act of 1996, has dramatically changed consumer options for acquiring services through multiple providers and different technologies.

In addition to providing the underpinning for transacting all kinds of business, the telecommunications industry itself is a large part of the state's economy. Industry employment, wages and revenues are major components of state economic activity.

EMPLOYMENT

As the following table shows, Texas Workforce Commission (TWC) figures record that 94,100 workers were employed in the industry in December 2004, meaning that about one in every one-hundred Texas workers was employed in telecommunications. An additional 18,000 were employed in the allied communications equipment manufacturing industry, bringing the combined total to 112,100.

Industry employment grew at a remarkable pace in the later half of the 1990s. Spurred by de-regulation and technological advances, employment grew by 59%, or 49,400 workers, over the five-year period from the end of 1995 to the end of 2000. Over the same period, total nonfarm employment grew by only 17%, some two and one-half times slower.

After that explosive growth, by the end of 2004 the industry had lost 39, 200, or about 29%, of its workforce. This decline was a due to the combination of a number of factors, including among others the general economic downturn, advancing infrastructure build out, competitive pressures, and consolidations within the industry. The drop in telecommunication employment far exceeded the one-half of one percent drop in the state's employment and comprised almost eighty percent of the state's net job loss.

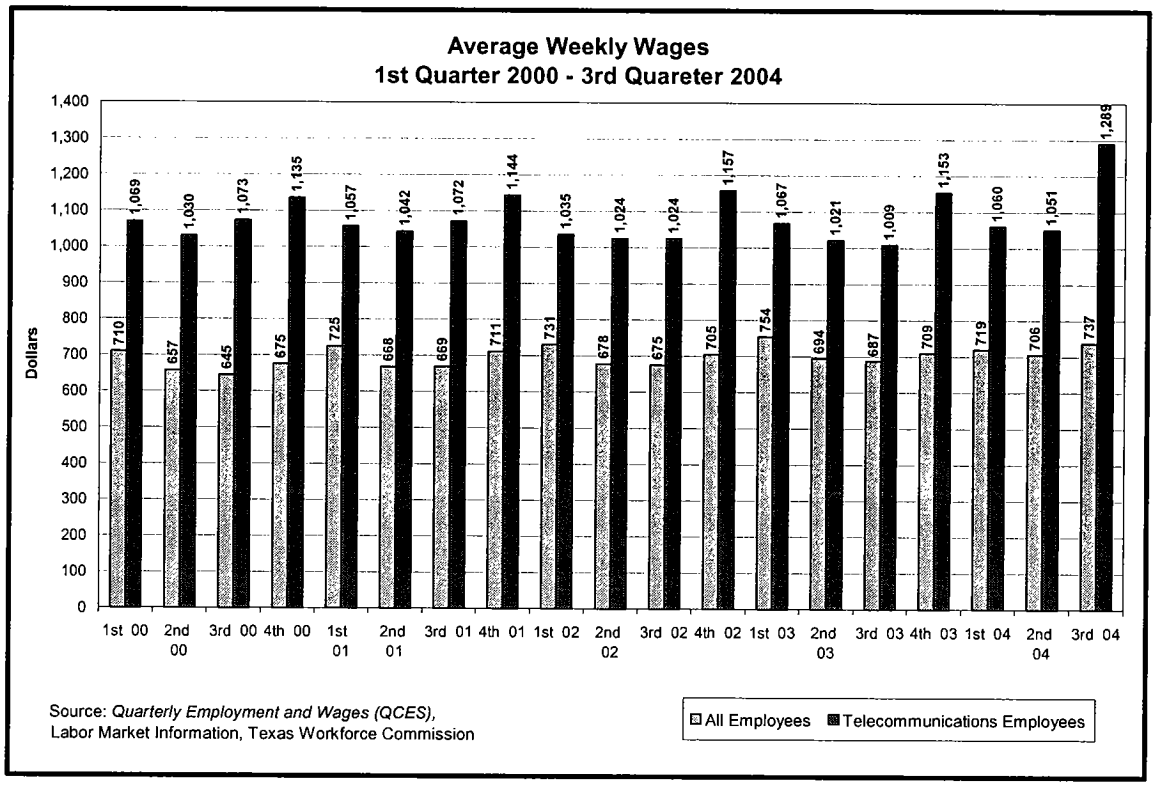
Telecommunications Industry Employment
Dec. 1990 - Dec. 2004

	Total Nonfarm	Telecommunications	Communications Equipment Manufacturing
2004	9,567,200	94,100	18,000
2003	9,530,300	95,100	18,100
2002	9,485,200	105,200	21,000
2001	9,508,400	121,100	28,200
2000	9,616,800	133,300	34,400
1999	9,359,100	119,000	31,400
1998	9,158,300	112,600	29,800
1997	8,842,500	106,900	29,500
1996	8,467,600	94,400	28,900
1995	8,209,500	83,900	25,900
1994	7,977,400	76,800	20,900
1993	7,647,800	72,300	19,200
1992	7,406,700	70,100	19,800
1991	7,264,400	70,600	22,200
1990	7,214,100	71,300	25,700

Source: *Monthly Employment Estimates (CES)*, Labor Market Information, Texas Workforce Commission

WAGES

Telecommunications workers have consistently earned significantly more than the all-industry average. As illustrated below, average weekly wages by industry reported by the TWC since the first quarter of 2000 show that telecommunications workers consistently earn about 50% more than the all-employees average. In the third quarter of 2004, the most recent period for which data is available, industry employees exceed the average by seventy-five percent.



Source: *Quarterly Employment and Wages (QCES),* Labor Market Information, Texas Workforce Commission

Almost one of every fifty dollars paid in wages in Texas goes to telecommunications employees, as shown in the following table. Over $1.6 billion, or about 1.9 percent of total wages, was paid to telecommunications workers in the third quarter of 2004 and a total of $5.8 billion was paid during 2003. Since telecommunications wages are much higher than the average, telecommunications workers' share of total wages is substantially higher than the portion that their number is of total employees.

Telecommunications Industry Wages
1st Quarter 2000 - 3rd Quarter 2004
(Billions $)

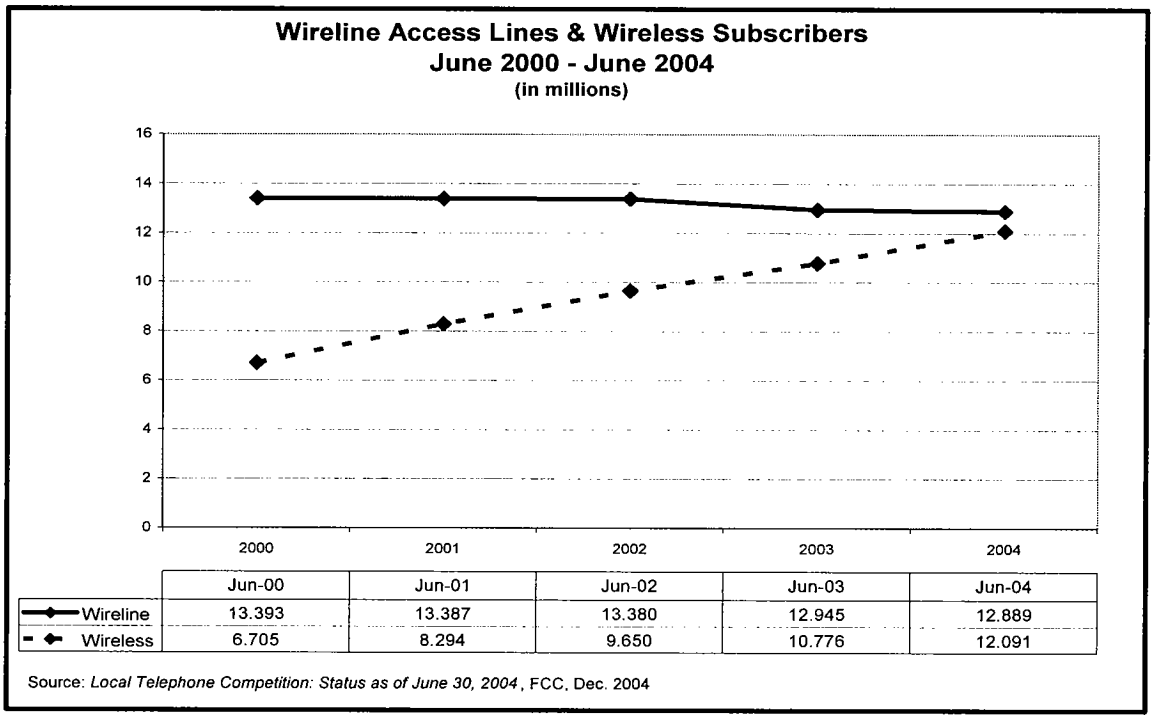
	Total Wages	Telecommmunications Wages	Telecommmunications % of Total
3rd - 04	$88.109	$1.637	1.86%
2nd - 04	$85.637	$1.302	1.52%
1st - 04	$87.087	$1.299	1.49%
4th - 03	$84.416	$1.598	1.89%
3rd - 03	$82.370	$1.366	1.66%
2nd - 03	$82.790	$1.378	1.66%
1st - 03	$90.791	$1.430	1.58%
4th - 02	$84.243	$1.789	2.12%
3rd - 02	$81.566	$1.504	1.84%
2nd - 02	$81.475	$1.442	1.77%
1st - 02	$88.409	$1.432	1.62%
4th - 01	$86.154	$1.909	2.22%
3rd - 01	$81.834	$1.787	2.18%
2nd - 01	$81.131	$1.696	2.09%
1st - 01	$87.962	$1.683	1.91%
4th - 00	$80.038	$1.800	2.25%
3rd - 00	$77.831	$1.761	2.26%
2nd - 00	$79.549	$1.769	2.22%
1st - 00	$86.937	$1.865	2.15%

Source: *Quarterly Employment and Wages (QCES)*, Labor Market Information, Texas Workforce Commission

MODES OF SERVICE

In recent years there has been a pronounced change in the way that consumers obtain telecommunications services, marked by the rapid growth in the number of wireless subscribers, evidenced by the ubiquitous cell phone, and in those acquiring high speed Internet access which can be used to transmit telecommunications due to the development of Voice Over Internet Protocol. There is nothing to suggest that this trend will change in the near future or that most consumers will not continue to acquire services in multiple ways.

The following graph shows the steady climb in the number of wireless subscribers and a corresponding decline in the number of telephone access lines. Over the four year period shown, wireless subscriptions grew by more than eighty percent. In contrast, wireline access declined almost four percent, or a reduction of more than a half-million lines. When available, new data may well show that the number of wireless subscribers now exceed the number of access lines.



	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04
Wireline	13.393	13.387	13.380	12.945	12.889
Wireless	6.705	8.294	9.650	10.776	12.091

Source: *Local Telephone Competition: Status as of June 30, 2004*, FCC, Dec. 2004

In addition to the changes in how consumers acquire telecommunications services, industry competition for local service has noticeably altered the provider mix. Independent Local Exchange Companies (ILECs), the dominant providers when deregulation began, have experienced a decreasing market share due to the growth of Competitive Local Exchange Carriers (CLECs), new entrants in the local service market since deregulation. The table below documents that as of June 2004 CLECs had over one-fifth of local access lines, more than doubling their number since 2000. In comparison, the number of ILEC lines dropped by more than two million, resulting in the more than one-half million overall decrease.

ILEC & CLEC Access Lines
June 2000 - June 2004

	ILEC Access Lines	ILEC % Total	CLEC Access Lines	CLEC % Total	Total
June-00	12,349,899	92.2%	1,042,606	7.8%	13,392,505
June-01	11,496,247	85.9%	1,891,131	14.1%	13,387,378
June-02	11,301,572	84.5%	2,078,465	15.5%	13,380,037
June-03	10,759,790	83.1%	2,185,850	16.9%	12,945,640
June-04	10,213,189	79.2%	2,675,784	20.8%	12,888,973
Change	-2,136,710		1,633,178		-503,532
% Change	-17.3%		156.6%		-3.8%

Source: *Local Telephone Competition: Status as of June 30, 2004,* FCC, Dec. 2004

The increasing demand for high speed Internet access is remarkable. As shown below, the total number of broadband subscribers grew more than seven fold from June 2000 to June 2004 when there were about two and one-quarter million subscribers in Texas. More consumers use cable for broadband access than asymmetric digital subscriber lines (ADSL), which is the technology that allows for access over existing copper telephone lines. Predictions are for this pattern to continue in the future and for high-speed Internet access to be necessary for full participation in the "new economy."

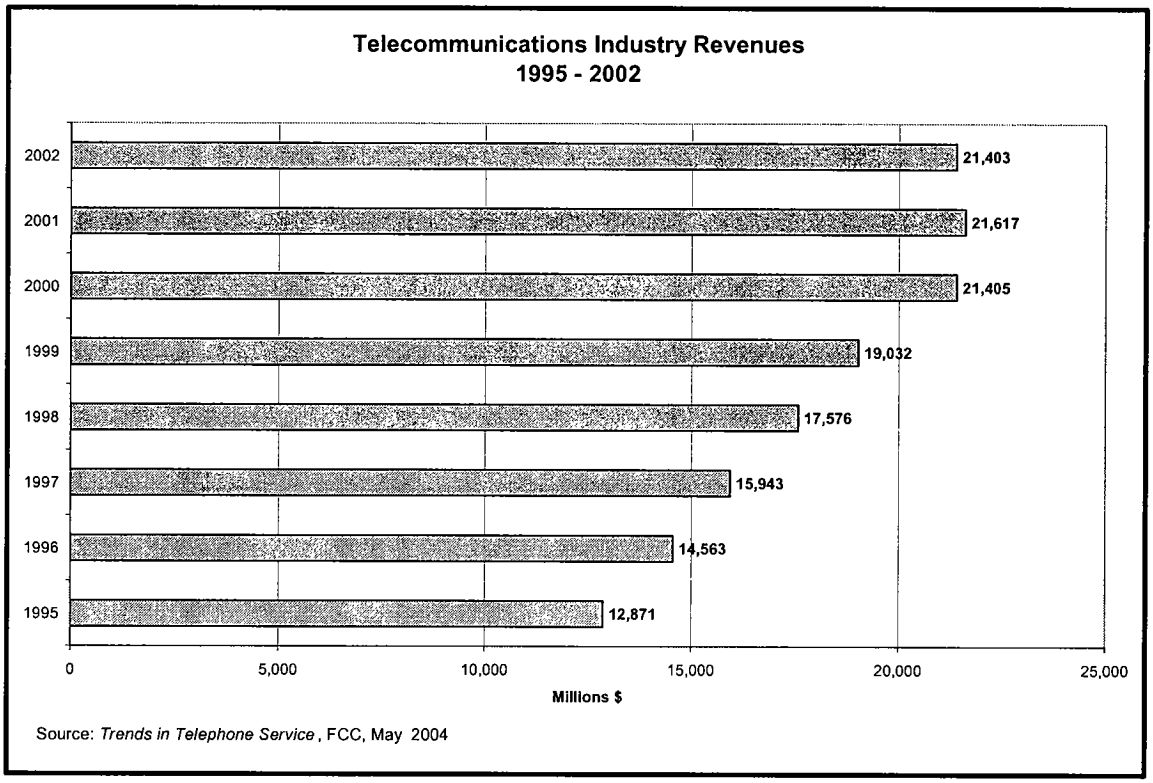
Broadband Subscribers
June 2000 - June 2004

	ADSL	Coaxial Cable	Other	Total
June-00	73,117	137,670	65,300	276,087
June-01	197,668	328,900	120,271	646,839
June-02	368,796	577,233	104,482	1,050,511
June-03	597,447	888,595	124,893	1,610,935
June-04	930,997	1,162,797	153,068	2,246,862
Change	857,880	1,025,127	87,768	1,970,775
% Change	1,173.3%	744.6%	134.4%	713.8%

Source: *High Speed Services for Internet Access: Status as of June 30, 2004*, FCC, Dec. 2004

REVENUES

Industry revenues have followed much the same pattern as observed in industry employment. The most recent data reported by the Federal Communications Commission (FCC), presented in the chart below, shows that telecommunications industry revenues in Texas jumped by about two-thirds from 1995 to 2000, at which time they leveled off at around $21.5 billion. The U.S. Census Bureau's *1997 Economic Census* showed that Texas telecommunications industry revenues accounted for about 1.8 percent of the state total for all industries.



Source: *Trends in Telephone Service*, FCC, May 2004

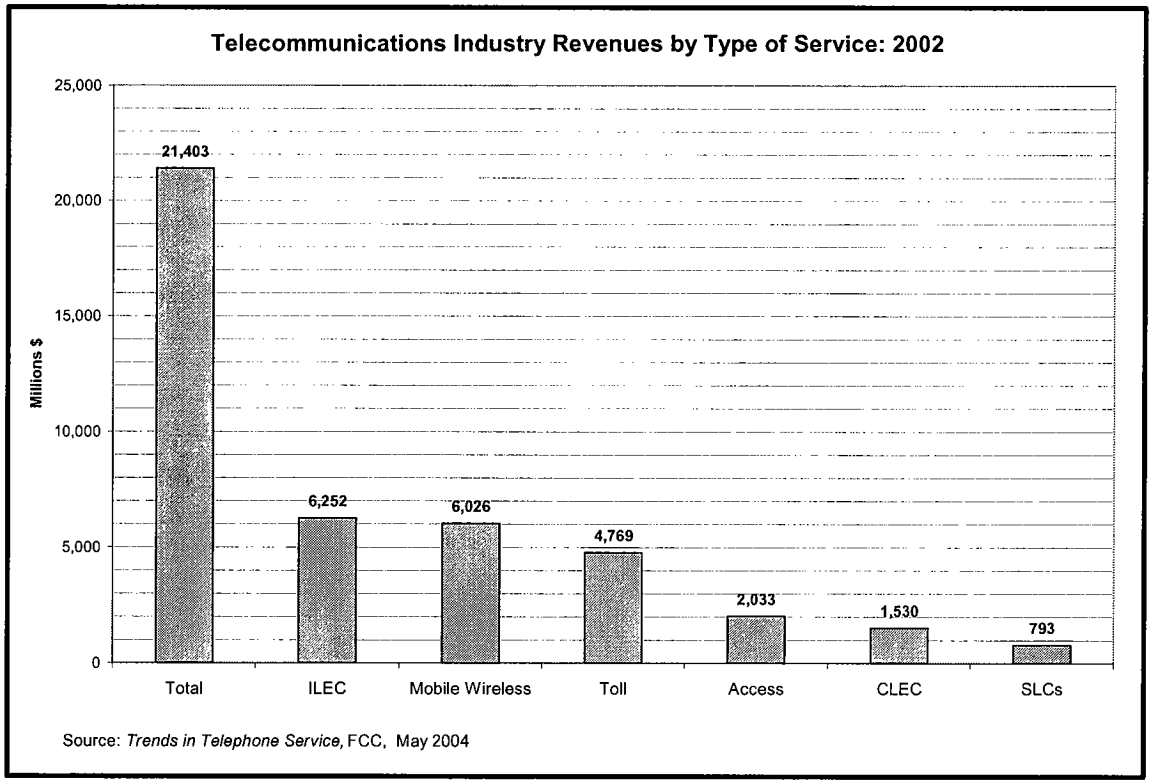
The following two graphics show how the FCC reports 2002 industry revenues were distributed by type of user and type of service. Almost four-fifths of total revenues came from end users of telecommunications services and the remainder came from payments made by one carrier to another, primarily for access to the local network. Also, total revenues were divided about two-thirds for intrastate service, which includes wireless charges, and one-third for interstate toll charges.

Telecommunications Industry Revenues by Type of User: 2002
(Millions $)

	Intrastate	% of Intrastate	Interstate	% of Interstate	Total	% of Total
End User	11,944	85.1%	4,969	67.5%	16,913	79.0%
Carrier's Carrier	2,093	14.9%	2,397	32.5%	4,49	21.0%
Total	14,037		7,366		21,403	
% of Total	65.6%		34.4%			

Source: *Trends in Telephone Service*, FCC, May 2004

In terms of type of service, more than $6.0 billion in revenue was derived from each of ILEC local exchange service and wireless service, together accounting for almost three-fifths of total revenue. Lesser amounts were attributable to toll charges, carrier access fees, CLEC local exchange service and special line charges (SLCs) such as those to support universal service.



Source: *Trends in Telephone Service*, FCC, May 2004

OVERALL ECONOMIC IMPACT

Although a major part of the state's economy in and of itself, the telecommunications industry's operations have a far reaching impact on other sectors of the economy as well. Industry output and the spending of its highly-paid workforce provide are major contributors to business activity in the state. Economic models have been developed to produce economic multipliers that estimate the impact that changes in one industry have on others.

There are output, earnings and jobs multipliers. The output and earnings multipliers, respectively, measure the predicted effect on total economic output and on earnings, or personal income, from a one dollar change in industry demand. The jobs multiplier predicts how many total jobs in the economy will be affected by adding one job in an industry.

The October 10, 2003 model run of the Regional Economic Analysis Division of the U.S. Department of Commerce's Bureau of Economic Analysis shows the following economic multipliers for the Texas telecommunications industry: output, 2.3; earnings, 0.59; and jobs, 4.7. Thus, a $1 increase in demand for telecommunications services in Texas generates $2.30 of business activity and increases personal income by $0.59. Every new telecommunications job creates a total of 4.7 Texas jobs.

TELECOMMUNICATIONS INDUSTRY TAXATION

Taxation of the telecommunications industry in Texas has a long and checkered history dating back to the early 1900s (see Telephone Taxes Timeline in Appendix). Taxes on the industry include all the taxes that are generally applicable to businesses (property, sales and franchise), industry specific taxes and transaction taxes on the purchase of telecommunications services by consumers.

Most of the scheme of telecommunications taxation developed during the time when it was a rate-regulated industry because of its "natural" monopoly character, wherein service was delivered over a network of telephone wires – neither of these conditions exists today. This construct provided a convenient vehicle for policy makers to levy taxes on the industry which were passed on to consumers in a less than completely transparent fashion as part of the rates charged for service. As a result, a complicated array of taxes (see Appendix for Summary Chart and individual tax profiles) developed over time and results in a tax burden on purchases of telecommunications services that is more than three and one-half times grater than that generally applicable to other taxable purchases. Although the industry is no longer a monopoly, the outdated tax scheme remains in existence and was extended to wireless providers that are not rate-regulated by the state.

GENERAL BUSINESS TAXES

The Comptroller reports that the telecommunications industry in 2003 paid $23.6 million in corporation franchise taxes and $17.1 million in use taxes on purchases of taxable goods and services. Reports submitted to the Comptroller by local property taxing jurisdictions show that in the 2002 tax year, a total of $318.3 million in property taxes was paid on telecommunications property -- $217.2 million to school districts, $50.6 million to cities and $50.5 million to counties. The Comptroller's telecommunications property category is comprised of all properties that are a necessary component of industry operations.

Property Tax

Unit Valuation. Utility properties, including telecommunications properties, are valued for property tax purposes using a unit method of appraisal which measures the value of all the assets of the company as one unit rather than the usual procedure of individually valuing each item of real and personal property owned by a taxpayer. Under the unit method, the utility company is valued as a going concern using the income method of appraisal in which an estimated future revenue stream is divided by a capitalization rate to arrive at an estimate of current value. The total unit value then is distributed among all of the taxing jurisdictions in which any of the company's property is located based on the proportion of total assets contained in each jurisdiction by using original acquisition cost data. Generally, utility companies are valued for county appraisal districts by a limited number of private contract appraisal firms. The taxes due to each jurisdiction are determined by applying the unit's tax rate to its apportioned utility value.

Intangible values are not subject to property taxation in Texas, but unitary valuation by its nature usually includes some amount of value derived from intangibles. Thus, an appropriate adjustment must be made to the total unit value to remove any included intangible values.

School Value Study. Each year, the Comptroller conducts a Property Value Study (PVS) to estimate the taxable property value in each school district for purposes of equitably distributing state aid and to measure appraisal level and uniformity in appraisal districts. The study begins in February of each year, and concludes in July of the next year. The Comptroller's preliminary findings must be released before February 1, followed by a period in which protests may be resolved.

Value estimates in the Comptroller's study are derived by testing a sample of properties in different property categories. The selection process for utility samples in a school district ensures sampling dominant properties, and properties of the largest utility companies are routinely among those tested. Sales data are rarely available for these properties and estimating the value of these properties is a very complicated task. The

Comptroller develops and employs computer models in testing the values of complex properties such as those of utilities.

Protests of preliminary values are allowed for school districts and any property owner whose property is used in the value study, provided that the total tax liability of all the owner's property in the school district's category sample is $100,000 or more. Appeals are decided by the Comptroller's hearings examiners. School districts are allowed a further appeal to the courts. Protesting taxpayers have no judicial remedy; for them, the Comptroller's ruling is final.

Although a property owner's tax liability is based on values determined by the county appraisal district, the value findings of the Comptroller have an indirect effect. Since state aid is distributed based on the Comptroller's values, the level of local property taxes required to finance school expenditures can be affected – less state aid requires more local taxes and vice versa. Further, if the Comptroller's values are higher than the appraisal district's, there is considerable pressure on local officials to raise values to match those of the Comptroller to prevent a possible reduction in state aid and to improve the Comptroller's rating of appraisal district performance. Because of the critical importance of the value study's results, allowing taxpayers an appeal beyond the Comptroller's ruling, within appropriate parameters that prevent frivolous or excessive numbers of appeals, could enhance accuracy and improve the uniformity of property tax administration.

Sales and Use Tax

Affiliated Entities Exemption. The initial expansion of the sales tax to services that occurred in 1984 made taxable the sale of amusements, cable television, personal services, motor vehicle parking and storage, and the maintenance and repair of certain tangible personal property. Telecommunications services were added in 1985. Another significant expansion was approved in 1987 when numerous additional services became taxable, including credit reporting, debt collection, information services, data processing, real property services, security services, insurance services and real property repair and remodeling.

As part of the 1987 sales tax expansion, a provision was added to the law providing an exemption for sales of services among affiliated entities, at least one of which is a corporation. However, the exemption was made applicable only to services that became taxable after September 1, 1987 – all those taxable before then, including telecommunications services, remained taxable when sold between affiliated entities.

As a result, telecommunications firms whose operations are segregated among different legal entities, often as required by state or federal law, must charge sales tax on the telecommunications services that are provided among their subsidiaries. The resulting

anomaly is that such telecommunications firms, in essence, must pay sales taxes on services provided to themselves.

Tax Pyramiding. A basic principle of a retail sales tax is that it is intended to be levied on the purchase of taxable goods and services by consumers for final consumption. Doing so avoids tax pyramiding – the levying of a tax on a tax – which in effect results in consumers paying higher and hidden sales taxes. Thus, a normative sales tax would exempt all intermediate purchases during the production process – that is all goods and services purchased to produce taxable goods or to provide taxable services.

No state has adopted such a "pure" sales tax and there is considerable variation among the states in the extent to which business inputs are exempted. The Texas sales tax has exemptions for major inputs used in the manufacture of tangible personal property, including materials, gas and electricity, packaging and wrapping supplies and machinery and equipment. In contrast, there are no comparable exemptions for business inputs used to provide taxable services and in fact the law specifically provides that machinery and equipment used to produce a taxable service is taxable to the person performing the service. Telecommunications providers must pay use tax on purchases of any equipment used to provide services that is not transferred to customers. Equipment that will be transferred to customers may be purchased tax free by means of a resale certificate given to the vendor in lieu of tax and in turn sales tax is collected from customers.

Thirty-seven states exempt, either fully or partially, purchases of manufacturing machinery and equipment for the two-fold purpose of avoiding tax pyramiding and to foster industrial expansion and capital investment. Although there is a discernible trend to do so, similar exempt treatment generally does not apply among states to purchases of telecommunications machinery and equipment. This is the case despite a universal desire, often accompanied by the enactment of special programs, to make advanced telecommunications services readily available statewide because access to such services is considered essential to sustaining future economic growth. Currently, exemption of telecommunications machinery and equipment purchases is provided in some fashion in only fifteen states plus the District of Columbia – a broad exemption in Arizona, D.C., Hawaii, Minnesota, Mississippi, Missouri, New York, Ohio, and West Virginia – a limited exemption in Alabama, Connecticut, Indiana, Michigan, New Jersey, North Carolina and Pennsylvania.

Tax pyramiding also occurs to the extent that industry-specific excise taxes are passed through to consumers as part of the purchase price. As will be discussed below, this is particularly true with respect to the taxation of telecommunications services in Texas. Aside from a few exceptions (i.e. the sales tax on tobacco products and alcoholic beverages and the separate 14% gross receipts tax on the sale of mixed drinks), the Texas tax system does not impose this sort of burden on the sale of other products and services.

INDUSTRY-SPECIFIC TAXES

Public Utility Gross Receipts Assessment

The Public Utility Regulatory Act of 1975 established the Public Utility Commission (PUC) to regulate rates and services of telephone, electric and water utilities and levied an assessment on the regulated utilities to defray the costs of administering the Act, although funds received were to be paid into the general revenue fund. The assessment was imposed at one-sixth of one percent of gross receipts. Regulation of long-distance companies was added in 1987 and water utilities were transferred to the Water Commission in 1985.

The assessment is on all public utilities, including long distance carriers, within the PUC's jurisdiction. This does not include commercial mobile radio services (i.e., wireless and paging) or customer-owned pay telephone services. Among certain excluded receipts are interstate long distance charges (including the intrastate portion of interstate calls), municipal franchise charges, and taxes levied on consumers. The assessment applies to rates charged all customers, including residential, commercial, governmental and exempt organizations. Reimbursement may be collected from customers if billed as a separate item that is properly labeled, and customer reimbursements are not included in the tax base.

Reports and payments are made to the Comptroller. The annual assessment period covers July 1 through June 30, and payment is due by August 15. Taxpayers may elect to make quarterly payments due on the fifteenth of May, August, November and February.

Receipts are deposited in the general revenue fund. The authorizing legislation in 1975 authorized the PUC, with approval of the legislature, to adjust the level of assessment in future periods to provide revenues sufficient to fund operations. Although that provision remained a part of the law until removed as part of the enactment of the Utilities Code in 1997, the rate was never changed despite the fact that revenues have consistently far exceeded agency operations costs. The $43.8 million collected in FY 2002 was $30.4 million more than twice the combined general revenue appropriations for the same year for the PUC ($11.8 million) and the Office of Public Utility Counsel ($1.7 million). The excess receipts are available for general appropriation.

Texas Infrastructure Fund (TIF) Assessment

The TIF was created in 1995 as part of House Bill 2128, the landmark legislation that brought sweeping changes to the regulation of the telecommunications industry in Texas. The TIF Board was charged with allocating $1.5 billion over 10 years in grants to Texas schools, universities, libraries, and hospitals to fund advanced telecommunications technology and infrastructure to enhance distance learning, information sharing and

general communications.

To provide the necessary funding, the Comptroller was directed to assess and collect a total of $150 million a year from the sellers of telecommunications services – $75 million from wireline providers and a like amount from wireless providers. Each year the Comptroller was to determine the rates estimated to be needed to raise the respective $75 million shares. Each individual provider's share of the overall industry assessment was based on the provider's share of the industry's total receipts subject to sales tax. In January 1996, a district court ruling found the tax constitutionally inequitable because the smaller wireless industry had been assessed the same $75 million a year as the much larger wireline industry, resulting in a tax rate for wireless providers that was about fives times that assessed against wireline providers.

In response to the court decision, the legislature amended the law in 1997 to levy the assessment at a flat rate of 1.25% on all telecommunications service provider receipts that are subject to sales tax. The fee may be billed separately by providers but must not be called a tax or fee. It must be labeled as a reimbursement to indicate that it is recouping a portion of the provider's TIF liability. Whether separately billed or included in the overall charge for telephone service, providers must collect sales tax on the TIF reimbursement because it becomes a part of the total sales price and therefore becomes a taxable telecommunications receipt for the next reporting period. Thus, the TIF reimbursement becomes part of the receipts for the next period on which the TIF is due.

In practice, the mechanics of passing the TIF assessment along to customers is not the same for all telecommunications providers. House Bill 2128 authorized service pricing flexibility for local exchange telephone companies that elected incentive regulation in return for making required infrastructure commitments to expand their customers' access to enhanced telecommunications technology. Pricing of services for electing companies was divided into three baskets: basic network services, discretionary services and competitive services. Although varying degrees of pricing flexibility were authorized for discretionary and competitive services, electing companies rates for basic services had to be frozen for four years from the date of election and could only be increased thereafter with PUC approval. All major local exchange carriers elected incentive regulation. Consequently, rather than being able to unilaterally pass through the TIF assessment to customers, they now must petition the PUC for approval of a rate increase to do so.

The 1995 authorizing legislation provided that TIF assessments were to be collected for ten years at $150 million a year for a total of $1.5 billion. When the flat rate was enacted in 1997 it was provided that total TIF assessments could not exceed $1.5 billion. The Comptroller was to adjust the rate accordingly in any year in which collections were expected to exceed the $1.5 billion limit.

In FY 2002, TIF assessments were $207.2 million and had totaled just over $1.1 billion in

the seven years that they had been collected. At that pace, it was anticipated that the $1.5 billion limit would be reached in 2004. Instead, as part of the budget balancing scheme for the 2004-05 appropriations bill, the 78th Legislature increased the cap by $250 million to $1.75 million, and considering current collection rates, extended the tax for an additional year. If no additional changes are enacted by the 79th Legislature, TIF assessments are expected to end in 2005.

The 2004-05 appropriations bill provided no funds for additional TIF grants, so any unexpended balances in the fund and the additional $250 million became available for general expenditure instead of retaining their original dedication to programs designed to promote access to advanced telecommunications services. The last grants authorized by the TIF Board were issued in August 2002, and the Governor issued an executive order transferring the management of outstanding grants to the Texas Workforce Commission effective September 1, 2003.

Texas Universal Service Fund (TUSF) Charge

The TUSF was established in 1987 to provide a mechanism for ensuring universal access to telecommunications services by subsidizing the cost of providing those services in high-cost rural areas and to low-income and hearing-impaired consumers. The TUSF is supported by a statewide uniform charge, or assessment, applied to the intrastate services receipts of telecommunications providers. The rate is set by the PUC based on program needs.

The TUSF assessment is payable by each telecommunications provider (local, long distance and wireless carrier) that has access to the Texas customer base. The assessment may be passed through to customers if it is billed as a separate item that is properly labeled.

The 1987 authorizing legislation gave the PUC the authority to specify a uniform statewide TUSF financing method. Prior to January 1, 1999, the assessment was hidden in PUC-approved long distance rates as part of the access charge that local telephone companies were allowed to charge long distance providers for hooking up with the local network to make in-state calls. Carriers were required to reduce rates for in-state long distance calls to reflect the access charge reductions caused by the new system, resulting in about a five-cent per minute reduction.

The PUC is the official governing agency of the TUSF but contracts with the National Exchange Carriers Association (NECA) to manage daily operations, including collecting data and assessments, investing fund balances and making disbursements to eligible recipients. Assessments are due annually, quarterly or monthly to the NECA depending on the amount due. Monthly payments are made if the amount due is more than $500.

TUSF now consists of nine program components and more than ninety percent of program expenditures are directed to providing affordable basic telephone service in high-cost, rural parts of the state through the Texas High Cost Universal Service Plan and the Small and Rural Incumbent Local Exchange Company Universal Service Plan.

The current 5.65% rate has been in place since September 1, 2004. Prior to that date, the assessment had been 3.6% of the receipts of telecommunications service providers that were taxable telecommunications services under the state sales and use tax, excluding pay telephone services which were exempted beginning September 1, 2001. The PUC changed the assessment in response to the June 30, 2004 decision of the U.S. Fifth Circuit Court of Appeals' in *AT&T Corp. v. Public Utility Commission of Texas,* 2004 WL 1334688 (5th Cir. 2004) which held that federal law preempted the assessment on charges for interstate and international calls.

In FY 2003, assessments totaled $556.9 million and program disbursements totaled $583.4 million.

Local Exchange Company Assessment

The 1987 legislation establishing the TUSF also contained significant changes to the rate setting and rulemaking authority of the PUC in determining and encouraging the level of market competition in the provision of telecommunications services. Among other changes, expedited rate setting was authorized to promote new services or promotional rates. The PUC also was charged with presenting to the Legislature at the beginning of each regular legislative session a comprehensive report on the scope of competition in regulated telecommunications markets and the impact on customers in both competitive and noncompetitive markets.

To defray compliance costs incurred by the PUC and the Office of Public Utility Counsel (OPUC) in implementing the new provisions, the PUC was authorized to prescribe and collect fees and assessments from telecommunications utilities certificated to provide local exchange service. Pursuant to this authority, an annual per-access-line assessment based on the number of lines in existence in the preceding year is levied on each local exchange company. The amount of the assessment is set each year by the PUC at a level that will produce sufficient revenue to cover relevant projected expenditures for the current fiscal year by the PUC and the OPUC. The per-access-line charge for 2004 was slightly over five cents per month.

Annual payments are made to the PUC, due before December 10, and deposited in the state's general revenue fund. FY 2004 receipts totaled $1.7 million.

Municipal Franchise (Right-of-Way) Fees

Municipal franchise, or right-of-way, fees compensate municipalities for the use of public rights-of-way (the area on, below or above streets, sidewalks, utility easements, etc.) by telecommunications companies and other utilities. The fees are paid in exchange for the right to place poles, conduit, cable, switches and related equipment in the right-of-way. This is defined to exclude the airwaves above a right-of-way for purposes of wireless communications.

In the past, fees paid to municipalities by telecommunications providers were determined by separately negotiated franchise agreements between individual cities and telecommunications providers. The amounts to be paid were determined by a variety of methods, such as percentage of gross revenues, a flat rate, or a per-foot or per-line charge. There was no law specifying the method or level of compensation that cities could collect for right-of-way use or for the right to provide services. This all changed when the 76th Legislature in 1999 passed HB 1777 to establish a uniform and exclusive method for compensating cities in order to reduce potential barriers to competition for existing companies and for new companies entering the marketplace. The goal was two-fold – provide fair compensation for cities while ensuring that fees charged for right-of-way use are competitively neutral and non-discriminatory.

The uniform system became operational for the second quarter of 2000 and applies to all certificated telecommunications providers (CTP), which are those authorized by the PUC to offer local exchange telephone service. Existing franchise agreements were not automatically invalidated and were allowed to remain in effect until their expiration date, but CTPs were allowed to elect to terminate franchise agreements and substitute the new PUC-directed uniform system, which consequently is now in place in all but a few cities.

The PUC currently administers a standardized methodology by which municipal franchise fees are calculated on a fee-per-access line basis. Maximum allowable fees, which vary in each municipality, are specified for three categories of access lines – residential, non-residential and point-to-point dedicated lines. The initial rates set by the PUC in 2000 generally were designed to provide cities with the same amount of revenue as received in 1998 in accordance with the franchise agreements and ordinances then in effect. Each city was allowed to choose an allocation formula that determined the rate for each category by specifying how much of the total should be collected from each access line category and, with approval, can change its allocation every two years. Rates are adjusted annually by the PUC by an amount equal to one-half of the increase in the Consumer Price Index.

Currently, the maximum allowable monthly rates established for 1,122 municipalities range up to $2.54 for residential lines, $6.21 for non-residential and $49.65 ($14.74 is the highest rate actually levied) for point-to-point. Cities may choose to impose franchise

fees at lower rates or to levy no fee at all and may change rates once a year. Amounts due are calculated monthly by multiplying the number of access lines in each category in the city, as reflected in quarterly reports to the PUC, by the applicable rate and payments are remitted quarterly by CTPs to each city in which they operate. CTPs are allowed to pass through these charges to end-use customers as a separately stated item on their bill.

CONSUMER TAXES

State Sales and Use Tax

The state sales and use tax was adopted in 1961 and applies to the purchase of tangible personal property, unless specifically exempted, and of designated services. Collection of the tax began September 1, 1961 at 2% and the rate has been increased seven times since then to the current 6.25%. The amount of the tax is added to the sales price and is a debt of the consumer until paid to the seller.

The dominant nationwide trend in sales taxation during the 1980s, as states struggled through difficult financial times, was expansion of the tax base to include certain services. Texas was no exception and numerous services were made taxable from 1984 to 1987. Telecommunications services became subject to sales taxation effective October 1, 1985.

For sales tax purposes, the term telecommunications services is broadly defined in the Tax Code as "the electronic or electrical transmission, conveyance, routing, or reception of sounds, signals, data, or information utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method now in existence or that may be devised, including but not limited to long-distance telephone service." Not included are data or information storage or processing to change its form or content, telephone prepaid calling cards, or Internet access, all of which are taxed under separate Tax Code provisions. Telephone prepaid calling cards are taxed similar to tangible personal property at the time of sale.

Taxes levied on telecommunications providers, including those that are passed forward to consumers as separately listed charges on phone bills, are deemed to become part of the sales price of the telecommunications service and therefore are subject to the sales tax in the same manner as the service itself. Thus, the sales tax is due on amounts paid by consumers to reimburse service providers for the public utility commission gross receipts tax, state and federal universal service charges, the state telecommunications infrastructure fund assessment and municipal franchise fees, all of which were discussed above. Taxes levied on consumers for which the provider has collection responsibility – state and local sales taxes, 9-1-1 emergency and poison control charges and the federal excise tax – are not in the sales tax base.

Depending on the amount to be remitted, sales tax payments are due annually, quarterly or monthly. Since monthly payments are required when amounts due exceed $500 a month or $1,500 a quarter, telecommunications providers report monthly and are allowed to retain 0.5% of the amount remitted on timely returns as reimbursement for collection costs. Those who prepay on the basis of a reasonable estimate, defined as at least 90% of the amount ultimately due or the amount paid in the same period in the preceding year, may retain an additional 1.25% of the amount of the prepayment.

Sourcing Rules. Sourcing in the context of taxation refers to the determination of which state and local taxing jurisdictions have the authority to levy any given tax and is most complicated with regard to transaction taxes, such as sales and use tax. Delineating the location at which a service is subject to tax is a technical, and often thorny, administrative problem and states have devised various rules to address the issue. The two most common are the place where the service is performed or the place where the benefit thereof is enjoyed. In Texas, services generally are sourced to the location where the direct or indirect benefit is derived.

Sourcing of telecommunications services, particularly long distance and wireless calls, presents some special problems and specific rules have been enacted to resolve them. The decision of where to tax with regard to wireline local exchange service is straightforward – the location of the telephone where the call originates. For private line services (a dedicated circuit between specific locations – most often used to transmit data), charges are apportioned on a mileage basis unless the Comptroller approves another method. Since pinning down the location of where the benefit of wireless communications and interstate long distance calls are enjoyed is more complicated, special rules apply to each.

Texas and most other states source long distance charges on a call-by-call basis in conformity with a 1989 U.S. Supreme Court decision. In that case, *Goldberg v Sweet*, a "two-out-of-three" rule is articulated whereby a state is permitted to tax interstate calls if the call either originates or terminates in the state and is billed to an address in the state. In Texas, the two-out-of-three standard is applied by administrative rule rather than being prescribed in statute. For local sales taxes, intrastate long distance calls are sourced to the location where the call originates, or to the address where it is billed if the point of origin cannot be determined.

Applying the two-out-of-three rule to wireless calls is impractical because of the inherent difficulty in identifying the precise location from which a call is placed or received and the additional complication resulting from the purchase of wireless service at a flat rate for a specified number of minutes rather than on a per call basis. To bring about a uniform method for sourcing wireless telecommunications services, Congress passed the Mobile Telecommunications Sourcing Act in 2000 to require all wireless calls to be sourced to the subscriber's residential or business address, whichever is the place of

primary use. Provisions of the federal Act were made part of the Texas Tax Code effective August 1, 2002.

A second sourcing issue relates to whether a sale is considered complete at its origin or its destination. Texas is one of three dozen states participating in the Streamlined Sales Tax Project (SSTP) to simplify and make more uniform the collection and administration of sales and use taxes. States entered into the SSTP to provide a basis for the adoption of federal legislation expanding state authority to require vendors without a physical presence in the state to collect taxes on sales to in-state purchasers. To become a member of the multi-state compact, states must enact whatever modifications are necessary to make their laws, rules, regulations, and policies substantially compliant with the requirements of the uniform agreement.

Legislation was adopted in the 2003 regular legislative session to bring Texas into compliance with SSTP, but there is considerable question as to whether it will be judged adequate to align Texas with the terms of the Streamlined Sales and Use Tax Agreement. The Agreement requires uniform destination sourcing of all sales transactions, but Texas retains origin sourcing for sales of goods for purposes of city and county sales taxes.

The SSTP Agreement sets out a specific set of rules for sourcing sales of telecommunications services:

- The "two-out-of-three" rule applies to services sold on a call-by-call basis.
- Services sold on other than a call-by-call basis are sourced to the customer's place of primary use.
- Mobile services are sourced in accordance with the federal Mobile Telecommunications Sourcing Act.
- Private line services in which termination points are located in different taxing jurisdictions are sourced fifty percent each to the origination and termination point.
- Prepaid calling cards generally are sourced in accordance with the sourcing rules applicable to sales of tangible personal property and post-paid calling service is sourced to the telecommunication signal's origination point.

Since Texas has played a prominent leadership role in the streamlined sales tax deliberations, our existing sales and use tax laws and regulations, including those relating to telecommunications sourcing, in large measure conform to the dictates of the Agreement. However, except for mobile telecommunications sourcing, most of the directives are found in administrative rules rather than in statute and necessary rule revisions are being made.

Bundling. This term refers to the marketing of multiple services for a single non-itemized charge. Combining taxable and non-taxable services raises the sales tax administration problem of how to tax the total price paid for the bundled services. This has become an especially troublesome issue in the sales taxation of telecommunications services because the convergence of telecommunications and entertainment technologies has led to a growing trend, in response to consumer demand, of bundling not only various telecommunications services but also other services such as cable television and Internet access. This trend is predicted to accelerate in the future and lead to new combinations of packaged services, the individual components of which may not fit neatly within existing taxable definitions.

Prior to passage of legislation in the 2003 regular session, Texas law required wireline telecommunications providers to separate charges for taxable and non-taxable services on all bills and invoices. In contrast, wireless providers were allowed, in conformity with the federal Mobile Telecommunications Sourcing Act, to offer bundled services for a single charge and to compute the tax due only on the taxable portion if books and records kept in the regular course of business could identify the taxable and nontaxable portions. Effective July 1, 2003, the same bundled charge billing rules that apply to wireless providers apply to wireline providers as well.

Local Sales and Use Tax

The 1985 legislation that made telecommunications services taxable under the state sales tax exempted them from local sales taxes. However, effective October 1, 1987, the governing body of a local sales taxing jurisdiction (city, county, transit authority or special purpose district) could vote to repeal the local exemption. If the exemption is repealed, local sales taxes on wireline service apply to local and intrastate long distance charges, but not to interstate long distance charges, just as under the state sales tax. All charges for wireless service are subject to local tax.

As of April 1, 2005, 488 jurisdictions impose local sales tax on telecommunications services: 420 cities, 30 counties, 7 transit authorities and 31 special purpose districts. Local sales taxing jurisdictions are authorized to levy the tax at varying rates, not to exceed an aggregate total of 2% – cities, 1/4%-2%; counties, 1/2%-1%; transit authorities, 1/4%-1%; and special purpose districts, 1/8%-1%.

Consistent with state sales tax sourcing rules, application of the local sales tax, except for wireless service charges, is based on the location from which a call originates or to the address where it is billed if the point of origin cannot be determined. Wireless service charges are sourced to the customer's residential or business address, whichever is the place of primary use, regardless of where the call originates or terminates.

Payments are remitted monthly, along with state sales tax, to the Comptroller who distributes revenues to the appropriate local jurisdiction based on allocation information submitted with the tax return.

9-1-1 Emergency & Poison Control Charges

The 9-1-1 emergency services are provided by a combination of home rule municipalities and single-purpose emergency communications districts, as well as regional planning commissions which operate the statewide program under contracts with the CSEC. The Texas Poison Center Network (TPCN) is operated by six regional poison centers that provide emergency treatment information, including a 24-hour toll free hotline and public education activities, under the direction of the Texas Department of Health (TDH).

Three fees and surcharges levied on consumers of telecommunications services provide funding for 9-1-1 emergency and poison control hotlines. The charges are a fifty-cent per-month 9-1-1 emergency service fee ($42 million in FY 02) on local exchange access lines (wireline) and on wireless connections and a 0.6% equalization surcharge ($14.4 million in FY 02) applied to charges, excluding taxes, for intrastate long-distance calls. One-half of equalization surcharge receipts are allocated to finance the state's poison control information network. The charges are collected by telecommunications providers, remitted to the Comptroller, and distributed by the Commission on State Emergency Communications (CSEC).

The local exchange access line fee was authorized in 1987 concurrent with the establishment of the state's 9-1-1 program and the wireless connection fee was added in 1997. A portion of the wireless 9-1-1 fee is intended to reimburse wireless carriers for compliance costs associated with federal mandates requiring wireless service to provide number and location identification for emergency calls in accordance with FCC standards. The equalization surcharge also was authorized in 1987 (at a 0.3% rate) to generate additional funds for regions of the state that would not collect sufficient funds from the access line fee to support 9-1-1 services. In 1993 the state's poison control program was established and was funded by a separate 0.3% surcharge. To simplify collection and reporting, the equalization and poison control surcharges were combined effective January 1, 2002, and the Comptroller was given collection responsibilities for 9-1-1 charges.

Prior to the Comptroller's commencement of consolidated collection, telecommunications providers made monthly wireline fee payments directly to the relevant regional planning commission or other designated local agency at varying rates, up to fifty cents per line, set by the CSEC. In addition, wireless connection fees, and equalization and poison control surcharges were remitted to the CSEC.

These charges are imposed on the customer and must be stated separately on the

customer's bill. The telecommunications service provider is responsible for collecting and monthly remitting receipts to the Comptroller, for which a one-percent administrative fee is retained. There is a separate reporting form for each of the three charges and the wireline fees must be reported by region according to the number of access lines in each of twenty-four regional planning commission areas to which receipts are distributed by the CSEC. Wireless fees are distributed by the CSEC to seventy-five service-providing jurisdictions based on the population served by each. One-half of equalization surcharges are distributed by the CSEC to regions where the emergency service fees do not fully offset 9-1-1 implementation and operational costs and one-half is allotted to the TDH to fund grants to the six poison control centers.

FEDERAL TAXES

Federal Excise Tax (FET)

The FET is a 3% tax imposed on the charges for local, long distance, wireless and teletypewriter exchange services. Any state or local taxes imposed on the sale or furnishing of telephone service is not included if separately stated on the consumer's bill.

The FET is an example of the old adage which holds that once a tax is enacted, even if it is labeled as "temporary" when adopted, the chances of it going away are slim. The FET was enacted in 1898 as a luxury tax to help pay for the Spanish-American war and at that time was imposed as a one-cent tax on all calls costing fifteen cents or more. It now is collected by the IRS as part of the federal government's general tax revenue and FY '02 receipts totaled $5.8 billion.

The tax is imposed on the consumer of telephone services and is collected by the service provider for remittance to the federal government. Generally, semimonthly deposits are required and collections are reported to the IRS on the Quarterly Federal Excise Tax Return (Form 720).

The tax has had a checkered history, having been repealed and reinstated several times since its inception in 1898. The rate has varied over time as well, reaching 25% at its highest point. The current 3% rate has remained unchanged since 1982. The most recent effort to eliminate the tax was in 2000 when Congress included its repeal in the federal appropriations bill, but general budget controversy with the administration ultimately resulted in the bill's veto by President Clinton.

Federal Universal Service Fund (FUSF) Charge

All telecommunications companies that provide service between states are assessed a charge to support the Federal Universal Service Fund (FUSF). The charge is an FCC

specified percentage, called the contribution factor, of interstate and international end-user revenues. FCC-directed changes were implemented in 2002 to eliminate the assessment of the contribution factor against universal service revenues. The contribution factor changes four times a year and is increased or decreased each quarter depending on the funding needs of FUSF programs as reflected in quarterly administrative filings of the fund administrator. The fourth quarter 2003 contribution factor is 9.2%, down from 9.5% in the preceding quarter.

Prior to 1996 only long distance companies paid fees to support the FUSF. In the Telecommunications Act of 1996, Congress expanded coverage by requiring all telecommunications companies that provide interstate services to contribute to the fund, including long distance, local, wireless and paging companies, and payphone providers. The Act required that contributions should be made in some equitable and nondiscriminatory manner and directed that specific, predictable and sufficient federal and state programs be established to preserve and advance universal service. In particular, all schools, health care providers, and libraries were to be afforded access to advanced telecommunications services.

The FCC directed the establishment of, and regulates, the Universal Service Administrative Company (USAC), an independent non-profit subsidiary corporation of the National Exchange Carrier Association (NECA), to administer universal service support mechanisms and to perform billing, collection, and funds distribution functions. Carriers submit quarterly and annually a Telecommunications Reporting Worksheet which lists revenues by category for the purpose of calculating required contributions that are paid monthly.

The contributions provide funding for four universal support mechanisms (High Cost, Low Income, Rural Health Care and Schools and Libraries) which subsidize the provision of discounted telecommunications services. High Cost allows customers in high cost, primarily rural, areas to obtain telephone service at prices comparable to those paid in more densely populated areas. Low Income helps qualified consumers pay for connection and monthly telephone charges. Rural Health Care enables qualified rural health care providers to pay no more than their urban counterparts for comparable services. Schools and Libraries, popularly known as "E-Rate," provides discounts from 20 to 90 percent on advanced telecommunications services for schools and libraries, with higher discounts for those located in rural and low-income areas. Carriers that provide these discounted services are compensated based on the submission of monthly invoices.

In 2002, USAC collected over $5.27 billion from service providers and dispersed over $5.35 billion to compensate for discounted services, $405.33 million of which was paid for services provided in Texas.

COMPARATIVE AGGREGATE TAX BURDEN STUDIES

Council on State Taxation (COST)

The most comprehensive and consistent state-by-state information on the state and local taxes and fees imposed on the telecommunications industry is prepared by the Telecommunications Tax Task Force of the Council on State Taxation (COST), a Washington D.C.-based, non-profit trade association of approximately 550 major multistate corporations from all sectors of industry. The Telecommunications Tax Task Force is comprised of numerous companies that provide a broad range of telecommunications services throughout the country. The initial report was released in 1999 and the third version, *2001 State Study and Report on Telecommunications Taxation*, is the most recent.

The report compares transactions taxes and fees and property taxes in effect as of July 1, 2001. It identifies and quantifies all the elements (rate, base, exemptions, jurisdictions applying each tax, etc.) of transaction taxes and fees that apply to purchases of tangible personal products and telecommunications services. Taxes applicable to a statewide provider of telecommunications services are analyzed.

Because of the complexity and variability of telecommunications taxation by state and local taxing jurisdictions, various assumptions were made to facilitate comparability of the data:

- If any segment of the telecommunications industry is taxed in a state, the average of the tax in the largest city and the capital city (or the second largest city if the capital is the largest city) was used for comparison purposes.
- When local tax rates varied, the average effective tax rate was applied.
- Taxes and fees levied on a flat rate per-line basis were converted to a percentage rate based on average monthly residential bills for 2000.

The data shows that total state and local taxes on the purchase of telecommunications services in Texas at 28.56% are the second highest in the country and just over double the national average of 13.9% (See table below). At that level, telecommunications services in Texas are taxed at three and one-half times the 8.25% state and local tax rate generally applicable to purchases of taxable goods and services, ranking sixth highest among all states (See table below).

Total State & Local Tax on Purchase of Telecom Services

Rank	State	Percent
1	VIRGINIA	29.77
2	**TEXAS**	**28.56**
3	MARYLAND	27.31
4	MISSOURI	23.79
5	NEBRASKA	23.64
6	FLORIDA	21.79
7	WEST VIRGINIA	21.52
8	ILLINOIS	19.47
9	WASHINGTON	19.26
10	GEORGIA	19.18
11	OKLAHOMA	19.04
12	PENNSYLVANIA	18.60
13	SOUTH CAROLINA	18.20
14	NORTH DAKOTA	17.62
15	DISTRICT OF COLUMBIA	17.54
16	UTAH	17.33
17	NEW YORK	17.26
18	NORTH CAROLINA	16.90
19	RHODE ISLAND	16.79
20	COLORADO	16.20
21	KANSAS	15.91
22	KENTUCKY	15.49
23	ARKANSAS	14.38
24	MISSISSIPPI	13.70
25	OREGON	13.20
26	ARIZONA	13.13
27	WYOMING	12.82
28	ALABAMA	12.75
29	TENNESSEE	12.67
30	CALIFORNIA	12.28
31	IOWA	11.74
32	MICHIGAN	11.00
33	LOUISIANA	10.58
34	INDIANA	10.18
35	ALASKA	9.53
36	SOUTH DAKOTA	9.22
37	OHIO	9.00
38	NEW HAMPSHIRE	8.60
39	NEW MEXICO	8.53
40	MINNESOTA	8.13
41	HAWAII	8.08
42	DELAWARE	8.04
43	WISCONSIN	7.13
44	MAINE	6.37
45	NEW JERSEY	6.21
46	IDAHO	6.16
47	CONNECTICUT	6.00
48	MONTANA	5.98
49	MASSACHUSETTS	5.07
50	VERMONT	4.36
51	NEVADA	2.89
	Average	13.90

Ratio of Telecom Tax Rate to General Sales Tax Rate

Rank	State	Ratio
1	VIRGINIA	6.62
2	MARYLAND	5.46
3	NEBRASKA	3.94
4	ALASKA	3.81
5	WEST VIRGINIA	3.59
6	**TEXAS**	**3.46**
7	MISSOURI	3.43
8	SOUTH CAROLINA	3.31
9	FLORIDA	3.11
10	DISTRICT OF COLUMBIA	3.05
11	NORTH DAKOTA	2.82
12	GEORGIA	2.74
13	PENNSYLVANIA	2.72
14	UTAH	2.70
15	NORTH CAROLINA	2.60
16	KENTUCKY	2.58
17	KANSAS	2.51
18	ILLINOIS	2.43
19	RHODE ISLAND	2.40
20	OKLAHOMA	2.40
21	COLORADO	2.35
22	WYOMING	2.33
23	IOWA	2.13
24	NEW YORK	2.12
25	WASHINGTON	2.07
26	INDIANA	2.04
27	HAWAII	2.02
28	ARKANSAS	2.02
29	MISSISSIPPI	1.89
30	MICHIGAN	1.83
31	ARIZONA	1.67
32	ALABAMA	1.59
33	SOUTH DAKOTA	1.54
34	TENNESSEE	1.54
35	CALIFORNIA	1.52
36	OHIO	1.41
37	MAINE	1.27
38	WISCONSIN	1.27
39	IDAHO	1.23
40	NEW MEXICO	1.19
41	LOUISIANA	1.18
42	MINNESOTA	1.16
43	NEW JERSEY	1.04
44	MASSACHUSETTS	1.01
45	CONNECTICUT	1.00
46	VERMONT	0.87
47	NEVADA	0.41
48	OREGON	0
49	NEW HAMPSHIRE	0
50	DELAWARE	0
51	MONTANA	0
	Average	2.28

Source: *2001 State Study and Report on Telecommunications Taxation*, by the Telecommunications Task Force of the Council of State Taxation (COST)

Ernst & Young

Another study that provides comparative data on estimated levels and composition of state and local taxes imposed on the telecommunications industry was conducted by the accounting firm of Ernst & Young LLP for the Telecommunications State and Local Tax Coalition whose members include the nation's major telecommunications companies. The report, *Telecommunications Taxes: 50-State Estimates of Excess State and Local Tax Burden*, was released in November, 2001 and provides state-by-state estimates of the level of transaction and business taxes paid by the industry in 1999.

Also included are estimates of the additional or "excess" taxes on telecommunications consumers and providers which measure the difference between estimates of taxes imposed on the telecommunications industry and estimates of taxes that telecommunications firms and their customers would pay if taxed in the manner generally applicable to other industries and retail products and services. Data used to derive the estimates came from public information collected by federal, state and local governments and from proprietary information provided by telecommunications firms.

The transaction taxes in the analysis included gross receipts, retail sales and use, 9-1-1 and other transaction taxes and fees imposed by state and local governments on local, wireless and long-distance telephone service providers and their customers, whether imposed on a transaction basis or on a flat, per-call or per-line basis. The business taxes included were property taxes, capital stock taxes on net worth, and the sales and use taxes on inputs purchased by telecom companies. Corporate income and franchise taxes based on net income were not included. Also excluded were flat-fee taxes and fees, such as right-of-way charges, that could not be converted to equivalent tax rates on telecommunications receipts or for which data was not available.

The telecommunications tax burden in each state expressed as a percentage of the total telecommunications taxes is shown below. These figures show the portion of the total taxes paid by telecommunications providers and consumers that are unique taxes not paid by general businesses or their customers. Texas fell just below the national average at 33.7%, meaning that telecommunications taxes in Texas are roughly one-third higher than those generally paid on other taxable items.

Another comparative measure of telecommunications tax burden is produced in the study by calculating the ratio of telecommunications taxes to the total revenues of the industry in each state, including revenues from local exchange, wireless, and long-distance service providers. As shown below, 12.6% of telecommunications industry revenues in Texas go to pay state and local taxes. On this measure, the industry tax burden in Texas is the fourth highest in the nation and is more than half again greater than the national average.

Unique Telecom Taxes as Percent of Total Telecom Taxes

Rank	State	Percent
1	NEW HAMPSHIRE	93.6
2	DISTRICT OF COLUMBIA	76.1
3	MONTANA	75.2
4	CALIFORNIA	75.0
5	OREGON	74.4
6	ALABAMA	72.3
7	VIRGINIA	67.0
8	DELAWARE	62.9
9	ALASKA	61.6
10	IDAHO	61.2
11	IOWA	54.2
12	FLORIDA	51.9
13	HAWAII	49.2
14	COLORADO	43.7
15	RHODE ISLAND	43.5
16	KANSAS	42.7
17	MISSOURI	42.2
18	NORTH CAROLINA	41.7
19	MARYLAND	41.5
20	GEORGIA	40.8
21	WYOMING	40.6
22	TENNESSEE	40.0
23	MISSISSIPPI	38.8
24	NEW YORK	36.8
25	SOUTH CAROLINA	36.6
26	SOUTH DAKOTA	36.6
27	PENNSYLVANIA	35.4
28	MINNESOTA	35.3
29	WISCONSIN	35.3
30	NEBRASKA	35.2
31	NORTH DAKOTA	34.5
32	OKLAHOMA	34.2
33	**TEXAS**	**33.7**
34	MAINE	30.8
35	OHIO	30.8
36	NEVADA	29.9
37	LOUISIANA	29.6
38	VERMONT	27.3
39	ILLINOIS	26.0
40	INDIANA	24.7
41	UTAH	23.4
42	CONNECTICUT	22.8
43	WASHINGTON	22.0
44	WEST VIRGINIA	22.0
45	NEW JERSEY	21.4
46	KENTUCKY	19.8
47	MASSACHUSETTS	16.7
48	ARKANSAS	16.4
49	MICHIGAN	14.9
50	ARIZONA	13.4
51	NEW MEXICO	6.6
	Average	40.0

Telecom Taxes as Percent of Total Telecom Industry Revenues

Rank	State	Percent
1	RHODE ISLAND	14.3
2	DISTRICT OF COLUMBIA	13.8
3	NEW YORK	13.0
4	UTAH	12.7
5	**TEXAS**	**12.6**
6	FLORIDA	12.3
7	OKLAHOMA	12.2
8	WASHINGTON	12.2
9	KENTUCKY	11.7
10	MISSISSIPPI	11.3
11	ILLINOIS	11.0
12	NEW MEXICO	11.0
13	CONNECTICUT	10.6
14	WISCONSIN	10.5
15	ARIZONA	9.6
16	MICHIGAN	9.6
17	SOUTH DAKOTA	9.5
18	TENNESSEE	9.3
19	MISSOURI	9.2
20	KANSAS	9.1
21	NEW JERSEY	9.1
22	MARYLAND	9.0
23	ARKANSAS	8.9
24	OHIO	8.9
25	COLORADO	8.5
26	NEBRASKA	8.1
27	PENNSYLVANIA	8.0
28	MASSACHUSETTS	7.9
29	IOWA	7.7
30	ALABAMA	7.6
31	MAINE	7.6
32	MONTANA	7.4
33	LOUISIANA	7.3
34	SOUTH CAROLINA	7.1
35	INDIANA	6.9
36	MINNESOTA	6.9
37	NORTH DAKOTA	6.9
38	HAWAII	6.6
39	WEST VIRGINIA	6.6
40	NEW HAMPSHIRE	6.5
41	CALIFORNIA	6.4
42	VERMONT	6.2
43	VIRGINIA	6.2
44	WYOMING	6.0
45	GEORGIA	5.7
46	NORTH CAROLINA	5.3
47	OREGON	4.9
48	IDAHO	4.7
49	DELAWARE	4.6
50	NEVADA	4.0
51	ALASKA	3.7
	Average	8.6

Source: *Telecommunications Taxes: 50-State Estimates of Excess State and Local Tax Burden,* prepared by Ernst & Young LLP for Telecommunications State and Local Tax Coalition, 2001

THE ROAD AHEAD

Technological advances are rapidly changing the face of the telecommunications industry. New technologies are enabling the continued blending and expansion of telecommunications services delivered by a variety of means, including wireline, wireless, or cable. Some predict that Voice over Internet Protocol (VOIP) which allows calls to be transmitted over the Internet will profoundly change the telecommunications industry in the not too distant future.

Further, to state the obvious, without telecommunications there would be no Internet or electronic commerce, which is rapidly becoming the dominant means of doing business around the world. Perhaps the most critical determinant of the future speed of growth of access to, and full participation in, the Internet and electronic commerce is the development and expansion of enhanced telecommunications services. The importance of telecommunications in both today's and tomorrow's economy strongly supports the need for a tax structure that will not impede expansion of the industry.

The Texas system of state and local taxation of telecommunications services, comprised of general sales and multiple industry-specific taxes imposed by multiple jurisdictions at different rates on different bases, is complicated, burdensome, and out of step with the evolving nature of the industry and with government policy goals. An inescapable consequence is that significantly more cost is added (whether denominated as taxes on consumers or as fees, charges or assessments on all or only some providers) to the purchase of telephone service than is added to the cost of purchasing other goods and services subject to sales taxation.

In large measure this tax policy came about because it was developed during the time when the telecommunications industry was a regulated monopoly. Under rate–of-return rate regulation, government regulatory authorities approve service pricing based on cost of service plus a reasonable rate-of-return so that firms are able to recover their costs of operation, including taxes, through higher rates. Thus, there was some justification for differential and disparate tax treatment because telecommunications service providers were assured of eventually recovering their tax outlays. In the new deregulated environment, prices are largely determined by marketplace competition and providers may not be equally able to recover tax costs.

In short, Texas now has an outdated telecommunications taxing scheme designed for a regulated monopoly environment that no longer exists. Texas is not alone in this regard. Although more states are acknowledging the problem and some have taken action to simplify, reduce and harmonize their telecommunications taxes, this is the exception rather than the rule. Most states, like Texas, continue to have an outmoded telecommunications tax policy.

Calls for Telecommunications Tax Reform

Two main goals of today's state and national telecommunications policy are to bring about lower rates by expanding market competition and to foster universal access to high-speed, broadband services. But as now configured, federal, state and local taxes are not compatible for the most part with the rapidly changing technology and increased deregulation that are now dominant features of the telecommunications industry. Current taxes are at best a hindrance and at worst an impediment to innovation and advancement of the industry. Policy makers have recognized the problem and recent national studies have called for fundamental reform.

ACEC. The Advisory Commission on Electronic Commerce (ACEC) was created by *The Internet Tax Freedom Act of 1998* (PL 105-277) and was charged with conducting a thorough study of, and making legislative recommendations concerning, the taxation of Internet transactions and access. Its April 2000 *Report to Congress* included majority findings that called for: placing a burden on states to radically simplify their "labyrinthine telecommunications tax systems" and to afford purchases of telecommunications equipment the same sales tax exemption treatment as afforded to manufacturing machinery purchases; eliminating the 3% federal excise tax; and eliminating excess property taxes on telecommunications providers.

NGA. A February 2002 report to the National Governors Association (NGA), *Telecommunications Tax Policies: Implications for the Digital Age*, concluded that "the current patchwork of industry specific taxes has become obsolete" and calls for state policymakers, as part of their economic development strategy for the new economy, to "thoroughly review their current telecommunications tax structure" so that tax policies will "promote, not stifle, economic growth in the digital age." Consequently, an Economic Development and Commerce Policy (EDC-8 State Priorities in Telecommunications Policy) adopted in 2002 by the NGA stated, in part, that current state tax systems "are often ill equipped to respond" to changes in the industry and supports a "review of existing state tax policies to determine their effect on telecommunications and the future growth of the industry."

NCSL. In November 1999, the Executive Committee Task Force on State and Local Taxation of Telecommunications and Electronic Commerce of the National Conference of State Legislatures (NCSL) submitted to the ACEC a *Proposal for State and Local Taxation of the Telecommunications Industry* that recommended: a phase-out of industry-specific and higher transaction taxes, property tax reform to treat telecommunications property the same as commercial and industrial property, and equal sales tax exemption treatment for purchases of telecommunications equipment as that applicable to purchases of other types of business equipment. In its 2003-2004 policy statement, *Twenty-first Century Telecommunications*, the NCSL recommends that "governments at all levels review and simplify their telecommunications tax policies" in order to treat all service

providers the same, to further economic development, and to ensure equal competition. In addition, the policy states that telecommunications transaction taxes and fees "should be simplified and modernized to minimize confusion and distortion" in the tax treatment of comparable services and service providers.

Reforms Begin

States are beginning to examine their situation and, as a result, some have taken steps to better align their state and local tax structure with their telecommunications policy goals. For example, Illinois and Florida are two states that have recently enacted a major telecommunications tax restructuring. While disparities remain in the combined tax rate on telecommunications services versus that on general business in each of these two states, both reform efforts resulted in a significant decrease in the administrative compliance burden for telecommunications providers and a reduction in the number of separate taxes listed on customer bills.

Illinois. Prior to adopting its reform legislation, Illinois had the dubious distinction of having the country's most complicated and burdensome system of telecommunications taxation, due primarily to the myriad combinations of three separate municipal taxes in addition to the state telecommunications tax. Since each tax required a separate monthly return to be filed with each municipality, most service providers had to file in excess of 10,000 tax returns a year. The Simplified Municipal Telecommunications Tax Act of 2001 (SB 88) consolidated all municipal taxes into a single tax with a standard base at a revenue neutral rate. All telecommunications services were taxed equally regardless of the mode of transmission and tax collection was centralized in the Illinois Department of Revenue. Also, action was taken in 2003 in HB 1273 to authorize a single charge for bundled services with taxes due computed only on the taxable portion, similar to the bundling provisions adopted in Texas as described above.

Florida. Effective October 1, 2001, the Florida Communications Services Tax Simplification Law of 2000 (SB 1338) restructured taxes on telecommunications, cable, direct-to-home satellite, and related services. Seven different state and local taxes were replaced and consolidated into a single tax comprised of two parts – a state tax and a local tax at locally determined rates. The tax applies to voice, data, audio, video, or any other information or signals (including cable services) that are transmitted by any medium. The new tax replaced state and local sales taxes, state gross receipts tax, local public service (municipal utility) tax, and local franchise or right-of-way fees. Administration of the tax is centralized in the Florida Department of Revenue. Further, legislation (HB 1225) was adopted in 2001 that provides a sales tax credit for purchases after July 1, 2000 of equipment used to deploy Internet-related broadband technologies.

Texas Reforms – Past and Future?

During the interim following the 1999 legislative session, the Senate Committee on Economic Development was charged with monitoring the PUC's implementation of legislation regarding the regulation of telecommunications utilities and the provision of telecommunications service. As part of its review, the Committee also examined the effect of state and local taxes on the fees and surcharges imposed on telecommunications providers and consumers.

In its *Interim Report to the 77th Legislature*, the Committee concluded that paying sales tax on fees that directly benefit federal, state or local government is duplicative and unnecessarily increases the price of telecommunications services. Consequently, it was recommended that the TIF assessment, the public utility gross receipts tax, and municipal franchise fees tax should not be subject to sales tax. In addition, the Committee concluded that further sales taxation of state and federal universal service charges may be counter productive to their purpose and recommended that they be further studied to determine whether they also should be exempted from the sales tax. Legislation (SB 547 and HB 1025) to exempt all the above taxes and charges form the sales tax was introduced in the 2001 session but failed to pass.

There has been some recognition by state policy makers of the mismatch between tax policy and the state's industry goals and recent legislative changes in telecommunications taxation have been enacted, primarily to reduce compliance costs for providers in order to encourage greater competition by lowering operational costs for new telecommunications market entrants. As described above, these measures include: SSTP compliance, bundled charge taxation, consolidated 911 and poison control charge collection, and simplified municipal franchise fee administration. Although resulting in significant improvements, this piece by piece approach may not be sufficient with regard to effectively achieving the state's avowed industry policy goals.

Given the rapid technological advances and growing competition that is transforming the industry, policy makers should undertake, either as a stand alone project or as part of a comprehensive tax restructuring effort, a critical review of the current telecommunications tax scheme to evaluate whether it is consistent with, and supportive of, the state's dual policy goals of encouraging competition to lower costs in the provision of telephone service and promoting the expansion of access to the advanced telecommunications services that are critical to full participation in the "new" economy. At a minimum, such a review should include a careful examination of the potential benefits to be gained from:

- Tax Simplification – combining industry-specific taxes.
- Tax Reduction – financing general government programs with general revenues instead of industry-specific charges.

- Tax Efficiency – extending the sales tax exemption for purchases of industrial machinery and equipment to include telecommunications machinery and equipment used to produce taxable services, especially that necessary for expanding broadband access.

APPENDIX

TELECOMMUNICATIONS TAXES TIMELINE

1898 – one penny federal excise tax on each long distance call costing more than 15 cents

1907 – 1 1/2% state telephone company gross receipts tax

1936 – telephone company gross receipts tax amended as follows:
- 1 1/2% on business done outside incorporated cities and within incorporated cities of less 2,500 population
- 1 3/4% within cities of 2,500 to 10,000
- 2% within cities of more than 10,000

1941 – gross receipts tax rate within cities over 10,000 population raised to 2.275%

1951 – gross receipts tax rates amended as follows:
- 1.65% outside cities and within less than 2,500 population
- 1.925% within cities of 2,500 to 10,000
- 2.5025% within cities of more than 10,000

1975 – 1/6 of 1% Public Utility Commission (PUC) gross receipts tax

1981 – collection of PUC gross receipts tax transferred to Comptroller

1982 – federal excise tax rate set at current 3%

1985 – state sales tax on telecommunication services

1987 – telephone gross receipts tax repealed effective 10/1/88

– local sales tax on telecommunication services

– long distance companies made subject to PUC gross receipts tax

– Texas Universal Service Fund (TUSF) charge established

– 911 emergency levies – 50-cents per local exchange access line charge and equalization surcharge NTE 0.5% on intra-state long distance calls

– local exchange company per-access-line assessment to defray PUC expenditures for rate setting, rulemaking and reporting

1993 – poison control surcharge NTE 0.5% on intra-state long distance calls

1995 – Texas Infrastructure Fund (TIF) assessment of $75 million each for wireline and wireless providers for ten years

1996 – federal universal service assessment on interstate and international calls

1997 – TIF assessment changed to uniform 1.25% of sales taxable services with retention of $1.5 billion overall assessment collection limit

– 911 50-cents per line charge on each wireless connection

1999 – TUSF assessment set at 3.6% of receipts taxable under the state sales and use tax

2000 – per line rates for municipal right-of-way fees set by PUC

2001 – adoption of the Mobile Telecommunications Sourcing Act effective 8/1/02

2002 – 911 equalization and poison control surcharges consolidated and Comptroller assumed collection of all 911 charges

2003 – TIF assessment collection limit raised $250 million to $1.75 billion

– elimination of the requirement that separate charges for taxable and non-taxable services be shown on all phone bills and invoices – allowing a single charge for bundled services with sales tax computed only on the taxable portion

2004 – TUSF charge changed to 5.65% of intrastate telecommunications services receipts

TEXAS TELECOMMUNICATIONS TAX SUMMARY

Tax, Charge, Assessment or Fee	Rate	Base	Levied On	Paid To	Payment Due	Deposited To	2004 Collections
State Sales Tax	6.25%	all telecommunications services	Consumer	Comptroller	monthly	state general revenue	$1 billion - est.
Local Sales Tax	NTE 2%	local access and intrastate long distance charges	Consumer	Comptroller	monthly	local jurisdiction general revenue	NA
9-1-1 Emergency Service Fee	50 cents per month	local access lines and wireless connections	Consumer	Comptroller	monthly	dedicated state general revenue account	$89.3 million
9-1-1 Equalization Surcharge	0.60%	intrastate long distance charges	Consumer	Comptroller	monthly	dedicated state general revenue account	$11.6 million
PUC Gross Receipts Tax	0.1667%	gross receipts from rates charged consumers	all public utilities (does not include wireless service providers)	Comptroller	annually or quarterly	state general revenue	$12.5 million - est.
Telecommunications Infrastructure Fund Assessment	1.25%	telecommunications services subject to sales tax	all telecommunications utilities and wireless service providers	Comptroller	quarterly	state general revenue	$200.3 million
Universal Service Fund Charge	5.65%	intrastate telecommunications services receipts	all telecommunications service providers	National Exchange Carrier Association (for PUC)	monthly	Universal Service Fund	$556.9 million - est. (2003)
Local Exchange Company Assessment	5 cents per month	local access lines	all local exchange companies	PUC	annually	state general revenue	$1.7 million
Municipal Franchise Fee	various per line monthly fees	local access lines	Wireline Service Providers	Cities	quarterly	city general revenue	NA

STATE SALES AND USE TAX

Authorization

State sales tax adopted in 1961. Telecommunications services added to the sales tax base effective October 1, 1985 by House Bill 1949, which passed in the 1985 regular legislative session. [Tax Code, Sec. 151.0101(a)(6)]

Base and Rate

State sales tax rate of 6.25% applies to the sale of all telecommunications services, including long-distance calls that both originate and are billed in Texas.
"Telecommunications services" is broadly defined (Tax Code, Sec. 151.0103) to include the electronic transmission or reception of sounds, signals, data or information using any "method now in existence or that may be devised."
It does not include data or information storage or processing to change its form or content, telephone prepaid calling cards, or Internet access.

Administration

Payment monthly to the Comptroller. One-half of one percent of the amount remitted on timely returns may be retained as reimbursement for collection costs. Additional 1.25% may be retained for prepayments.

Revenue

Estimated FY 2004 sales tax receipts attributable to taxation of telecommunications services were $1 billion out of total state sales tax collections of $15.4 billion.

Note

Charges levied on telecommunications providers (such as TIF Assessment, PUC Gross Receipts Tax, Universal Service Fund Charge, and Municipal Franchise Fees) are considered part of the total sales price for the services provided and therefore are subject to the sales tax. These charges are collected on phone bills as reimbursements to the provider and not as a tax on the consumer. In contrast, charges levied on the consumer (state and local sales taxes and the 911 Emergency Service Fee and Equalization Surcharge) are passed through on phone bills as a tax or fee on the consumer and are not part of the sales tax base.

LOCAL SALES AND USE TAX

Authorization

The same 1985 legislation, House Bill 1949, that subjected telecommunications services to the state sales tax made them subject to local option sales taxes effective October 1, 1987. (cities – Tax Code, Sec. 321.201; counties – Tax Code, Sec. 323.208; transit authorities – Transportation Code, Sec. 451.404; special purpose districts – Tax Code, Sec. 322.109)

Base and Rate

Local jurisdictions are authorized to levy sales tax at varying rates: cities, 1/4%-2%; counties, 1/2%-1%; transit authorities, 1/4%-1%; and special purpose districts, 1/8%-1%. Total local rate cannot exceed 2%. The rate in effect at any location depends on the number and type of local taxing jurisdictions that impose the tax and the rate at which each levies the tax. A total of 468 jurisdictions currently impose local sales tax on telecommunications services: 409 cities, 29 counties, 6 transit authorities and 24 special purpose districts. Tax applies to local and intrastate long-distance charges. Interstate long-distance charges are exempt.

Administration

Payment monthly to the Comptroller who remits the local revenue to the appropriate jurisdictions based on tax return information. One-half of one percent of the amount remitted on timely returns may be retained as reimbursement for collection costs. Additional 1.25% may be retained for prepayments.

Revenue

NA

Note

State law exempts telecommunications services from all local sales taxes, but allows the governing bodies of local taxing jurisdictions to override the exemption by voting to impose sales tax on these services. Local sales taxes are allocated to the location from which a call originates or to the address where it is billed if the point of origin cannot be determined.

9-1-1 EMERGENCY SERVICE FEE

Authorization

The 9-1-1 emergency communications program is funded with three charges – a per-line fee on both local exchange access (wireline) and on wireless connections and a surcharge on intrastate long-distance calls. The local exchange access fee was authorized in 1987 with the establishment of the state's 911 program and the wireless fee was added in 1997. (Health and Safety Code, Sec. 771.071)

Base and Rate

The fee is fifty cents per month for each local exchange access line, or equivalent local exchange access line, and for each wireless communications connection. The fee is imposed on the customer and must be stated separately on the customer's bill. The service provider retains a one-percent administrative fee for collection and remittance.

Administration

Payment monthly to the Comptroller. Separate reporting forms for the wireline and wireless fees and the wireline fees must be reported by region according to the number of access lines in each of twenty-four regional planning commission areas.

Revenue

Collections totaled $42.1 million in FY 2003.

Note

Commission on State Emergency Communications (CSEC) is the state agency charged with administering the 9-1-1 program and in that capacity distributes revenues to service providers in the twenty-four regional Councils of Governments (COGs) responsible for program operations. Collection of the wireline fee was centralized effective January 1, 2002 when the Comptroller assumed collection responsibilities for all 9-1-1 charges. Prior to that time, the monthly wireline fee payments were made to the relevant regional planning commission or other designated local agency at varying rates, up to fifty cents, set by the CSEC. Wireless fees are distributed by the CSEC to seventy-five service-providing jurisdictions based on the population served by each.

9-1-1 EQUALIZATION SURCHARGE & POISON CONTROL CHARGE

Authorization

The 9-1-1 equalization surcharge first authorized in 1987 in conjunction with the local exchange access line fee. Purpose was to generate additional funds for regions that would not collect sufficient funds from the access line fee. In 1993 the state's poison control program was established and was funded by a separate surcharge. To simplify collection and reporting, the two surcharges have been combined. (Health and Safety Code, Sec. 771.072)

Base and Rate

Rates set annually by CSEC – NTE 0.5% for 9-1-1 equalization and 0.8% for poison control. Current combined rate is 0.6 percent of monthly intrastate long-distance charges. Like the 9-1-1 emergency service fee, the surcharge fee is imposed on the customer and must be stated separately on the customer's bill. The service provider is responsible for collecting and remitting the fee and retains a one-percent administrative fee.

Administration

Monthly payment to the Comptroller.

Revenue

$11.6 million in FY 2004

Note

One-half of surcharge receipts allocated by the CSEC to regional planning commissions to support the 9-1-1 program. One-half allocated through the CSEC to the Texas Department of Health to fund grants to six Regional Poison Centers that operate the state's poison control program.

PUBLIC UTILITY GROSS RECEIPTS ASSESSMENT

Authorization

Enacted in 1975 as funding mechanism for the newly created Public Utility Commission. (Utilities Code, Sec. 16.001)

Base and Rate

All public utilities (does not include wireless providers), including long-distance companies, pay one-sixth of one percent of gross receipts from rates charged to ultimate consumers in Texas.

Administration

Annual payment to the Comptroller due August 15, but payments may be made quarterly at taxpayer discretion.

Revenue

Estimated $12.5 million in FY 2004.

Note

Revenues deposited in the state's general revenue fund. In FY 2004, gross receipts assessments of all utilities totaled $41.6 million, which was $29.9 million more than the general revenue appropriations for the same year to the PUCT ($10.2 million) and the Office of Public Utility Counsel ($1.5 million) combined.

TEXAS INFRASTRUCTURE FUND (TIF) ASSESSMENT

Authorization

The TIF was created in 1995 as part of House Bill 2128, the landmark legislation that brought sweeping changes to telecommunications regulation. Original assessment was $75 million-a-year for ten years each on wireline providers and wireless providers. Each individual provider's share of the overall industry assessment was based on the provider's share of the industry's total receipts subject to sales tax. Amended in 1997 to levy the assessment at a uniform 1.25%. (Utilities Code, Sec. 57.048)

Base and Rate

The assessment is levied at 1.25% times the receipts of telecommunications utilities and commercial mobile service providers that are taxable telecommunications services under the state sales and use tax. The assessment is levied on service providers who may choose to pass it through on their customers' bills as a separately stated and properly labeled charge. Local exchange companies that elected incentive regulation (partial deregulation as provided in Utilities Code, Chap. 58) in effect are unable to pass the charge through to customers without petitioning PUC for a rate increase. Electing company rates for basic services were frozen for four years and increases thereafter require PUC approval.

Administration

Quarterly payment to the Comptroller.

Revenue

TIF assessments were $200.3 million in FY 2004 and have totaled just over $1.5 billion since their inception.

Note

The 1997 TIF amendment retained the $1.5 billion cap and provided that the TIF would terminate when that amount had been collected or after 10 years, whichever came first. At current collection rates, it was anticipated that the overall cap would have been reached in 2004 at which time the TIF would have ceased to exist. However, in the 2003 regular legislative session the cap was increased by $250 million to $1.75 billion and, in effect considering current collection rates, extended the tax for another year (Secs. 59 & 60, HB 3459, 78th Legislature).

TEXAS UNIVERSAL SERVICE FUND (TUSF) CHARGE

Authorization

The TUSF was established in 1987 to provide a mechanism for ensuring universal access to telecommunications services by subsidizing the cost of providing those services in high-cost rural areas and to low-income and hearing-impaired consumers. (Public Utility Code Sec. 56.022)

Base and Rate

The current rate, set by the PUCT based on program needs, is 5.65% of intrastate telecommunications services receipts of all providers of telecommunications services. Prior to the current rate's September 1, 2004 effective date, the rate had been 3.6% of receipts taxable under the state sales and use tax. The rate change was made in response to the U.S. Fifth Circuit Court of Appeals' ruling in *AT&T Corp. v. Public Utility Commission of Texas,* 2004 WL 1334688 (5th Cir. 2004) that assessment of TUSF charges on interstate and international calls is preempted by federal law. Providers may determine the amount of their assessment by using actual intrastate receipts or a PUC-specified percentage of receipts for bundled offerings. The charge may be passed through to consumers on their monthly bills and if so is subject to the sales tax.

Administration

The PUCT is the TUSF's official governing agency but contracts with the National Exchange Carriers Association (NECA) to manage daily operations, including collecting assessments, investing fund balances and making payments to eligible recipients. Monthly payment to NECA.

Revenue

Assessments totaled $556.9 million in FY 2003 and program disbursements totaled $583.4 million.

Note

Both the programs funded by the TUSF and the funding mechanism have changed over time. Prior to 1999 the charges were hidden in long distance rates as part of the access charge that long distance companies paid to local telephone companies to make in-state calls. TUSF now consists of nine major components and approximately ninety percent of program expenditures are directed to providing affordable basic telephone service in high-cost, rural parts of the state.

LOCAL EXCHANGE COMPANY ASSESSMENT

Authorization

Enacted in 1987 to offset certain expenditures associated with telephone industry regulation by the Public Utility Commission and the Office of Public Utility Counsel. (Utilities Code, Sec. 52.060)

Base and Rate

All local exchange companies pay a per-access-line assessment (based on the number of lines in existence during the preceding year) at a rate established annually by the PUC at an amount needed to produce revenue sufficient to pay the projected expenditures of the PUC and the OPUC under the PURA associated with rate setting, rulemaking and preparing the *Scope of Competition* submitted to the Legislature prior to each regular session. The 2004 monthly rate was just over five-cents per access line.

Administration

Annual payment to the PUC due December 10.

Revenue

$1.7 million in FY 2004.

Note

Revenues deposited in the state's general revenue fund.

MUNICIPAL FRANCHISE (RIGHT-OF-WAY) FEES

Authorization

The present uniform method for compensating cities for the use of public rights-of-way by telecommunications providers was established with the passage of House Bill 1777 in 1999 and became operational for the second quarter of 2000. Prior to that time, the compensation paid to cities was determined through separately negotiated franchise agreements between individual cities and telecommunications providers. (Local Government Code, Sec. 283.051)

Base and Rate

PUC determines maximum rates for each of three categories of access lines in each municipality. Thus, fees vary by city and by type of customer. Varying rates for residential, non-residential and point-to-point access lines have been established for 1,122 municipalities. Current maximum allowed rates range up to $2.54 for residential lines, $6.21 for non-residential and $49.65 ($14.74 is the highest rate actually levied) for point-to-point. Rates are adjusted annually by an amount equal to one-half of the increase in the Consumer Price Index. Amounts due are determined by multiplying the approved access line rates by the number of lines in each category that a telecommunications provider has within a city as reported quarterly to the PUC. The fee may be passed through to consumers on their monthly bills as a separately stated charge and if so is subject to the sales tax.

Administration

Quarterly payments, calculated monthly, are made to each affected municipality.

Revenue
NA

Note
A uniform method of municipal franchise fee administration was instituted to encourage competition in the industry by providing fair compensation for municipalities while ensuring that fees are competitively neutral and non-discriminatory. Initial rates set by the PUC in 2000 generally were designed to provide cities with the same amount of revenue that they received in 1998 in accordance with franchise agreements and ordinances then in effect. Existing franchise agreements were not invalidated and were allowed to remain in effect until their expiration date, but with few exceptions, cities chose to opt out of them. Cities were allowed to direct the allocation of the initial payments among the three categories of access lines and are allowed to request a modification of the allocation every two years.

The Texas Taxpayers and Research Association (TTARA) and the TTARA Research Foundation are non-profit associations of businesses and individuals interested in state and local fiscal policy and other policy issues. They are the successor organizations to the Texas Association of Taxpayers and the Texas Research League, respectively.

TTARA and the TTARA Research Foundation work to improve the business climate of Texas by fostering sound fiscal and public policy. This work is supported by businesses and individuals who wish:

- to bring about more responsible government,
- to gain access to more and better state fiscal information, and
- to have their point of view effectively presented.

TTARA and the TTARA Research Foundation use the power of information to effect change. They investigate and analyze the use of public resources and educate the TTARA membership, the general public, and public officials on the results of those investigations.

The TTARA Research Foundation's role is to conduct research related to economic, fiscal and public policy issues in Texas and to make factual analyses and reports regarding those issues.