

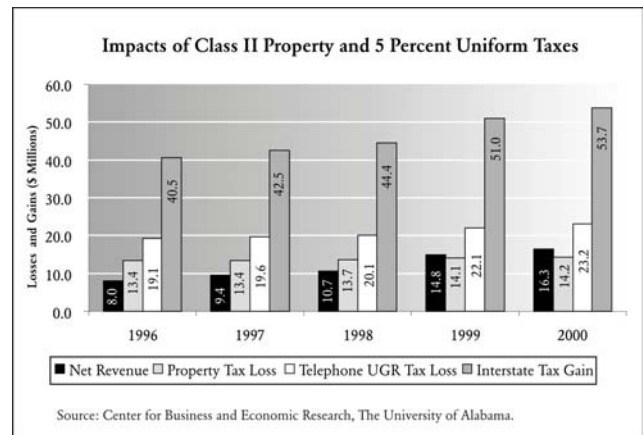
# Some Implications of an Alabama Telecommunications Industry Tax Reform

Is there a need for a telecommunications industry tax reform in Alabama? Currently, wireless and wired local services are taxed at 4.0 and 6.7 percent, respectively. Wireless local services refer to local or intrastate cellular or mobile telephone services. Wired local services are the local or intrastate landline telephone services. The Alabama telecommunications tax structure provides an effectively lower tax for large consumers of telecommunications services. Wireless providers alone are exempted from Class I utility classification, enabling them to pay lower Class II property taxes. Class I property is assessed at 30 percent and Class II at 20 percent for property tax purposes. Interstate telecommunications services are not taxed in Alabama. Thirty-five states currently have sales/excise tax on interstate telecommunications services, up from only five in 1984.

Proponents of a telecom industry tax reform in the state will point out the unfairness of the current tax treatment and note that it hinders competition. Opponents might raise the need to support an infant industry argument, in response to which proponents might question the infancy of cellular and interstate telephone. In any case, inequitable advantages and disadvantages within any industry adversely impact the state economy.

An industry-wide classification for property taxes and a uniform tax rate on telecommunications services seem more equitable. Such treatment will inevitably result in revenue losses and gains for taxing jurisdictions, as well as revenue distribution requirements. Thus, mechanisms for maintaining revenue neutrality for taxing jurisdictions and Funds must be considered in any tax reform. For example, collecting interstate services tax as gross utility taxes would benefit the Education Trust Fund.

Some implications of an industry-wide Class II property tax classification and a uniform 5 percent tax rate on local, intrastate, and interstate telecommunications services for the past five years are shown in the chart below. Net revenues increase over the period, since taxable telecommunications revenue grows much faster than the industry's property tax payments. Focusing on 2000, class II property tax classification for the entire telecommunications industry would have reduced property tax receipts by \$14.2 million.



Lowering the tax rate on wired local and intrastate services to 5 percent results in a loss of \$23.2 million. However, \$53.7 million in interstate tax revenue would have been generated for a net revenue gain of \$16.3 million.

The analysis in the preceding paragraph does not include the impact on cellular, since cellular telephone taxes are collected separately and not as utility gross receipts tax. Applying the proposed uniform 5 percent to cellular would have raised an extra \$7.0 million in 2000. Of course, higher uniform rates would raise even more revenue. The proposed changes create a fiscal atmosphere conducive to furthering competition in the industry with its attendant benefits of choice, improved quality, and lower prices for consumers. Uniform taxes are transparent and fair, simple, and cheap to administer.

It is important to note that revenue generation implies a tax increase on consumers, although it may be negligible as is the case here. Telephone service expenditures constitute only about 2 percent of household expenditures. The 5 percent tax rate proposed here will increase household telephone expenditures by only 0.01 percent of total household expenditures. This may be more than offset by the decreasing price effect of increased competition and the extra government services that the tax revenues could provide.

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