



February 13, 2004

Honorable Lamar Alexander  
United States Senate  
Washington, DC 20510

Dear Senator:

This letter responds to several questions you posed to CBO about state telecommunications taxes.

**What are the components of telecommunications taxes collected by state and local governments? How much of these revenues could be affected by the enactment of S. 150, the Internet Tax Nondiscrimination Act (ITNA)?**

Based on information from industry representatives, state and local governments, and federal statistical sources, CBO estimates that state and local governments currently collect more than \$20 billion annually from taxes on telecommunications services. These taxes fall into two broad categories: business taxes and transactions taxes. Business taxes include property taxes, corporate income taxes, sales taxes on business inputs, and capital stock taxes. They account for about one-third of the taxes telecommunications companies pay annually (about \$7 billion), and do not appear to be directly affected by S. 150 (version MGR.6).

The remaining two-thirds (at least \$13 billion) are known broadly as transactions taxes and include gross receipts taxes, sales and use taxes, 911 fees, state universal service fund (USF) fees, and other taxes that are levied on telecommunications transactions. Section 1107 of the Managers' Amendment to S. 150 explicitly states that 911 taxes and USF fees would not be affected by the prohibitions in the bill. Based on information from the National Emergency Number Association (NENA), we estimate that 911 fees—which

almost all states levy on telephone service—account for between \$2 billion and \$3 billion of transactions taxes collected. State USF fees—which fewer than 20 states levy—account for less than \$1 billion of transactions taxes collected.

How much of the remaining transactions taxes (at least \$10 billion) could be affected by the enactment of S. 150 is unclear and depends on a variety of technological changes, legal interpretations, and regulatory decisions. A major issue in determining how much is at risk will be how quickly telecommunications services migrate to the Internet.

**How quickly will telecommunication services “migrate” to the Internet; and how much state and local revenue could be affected?**

The rate at which telecommunications services “migrate” to the Internet will depend on a number of factors, including actions by the Federal Communications Commission, improvements in technology, and consumer choices, as well as the nature of any legislation enacted. However, most industry experts expect that less than one-third of current voice telecommunications services will move to the Internet over the next five years. This suggests that over that period, less than \$3 billion annually in state and local telecommunications taxes could be affected by the enactment of ITNA.

**How many states tax cable?**

About half of states tax cable services, with some states only taxing “premium” cable services. In addition, all cable companies pay, and pass through to their customers, franchise taxes.

**How much revenue did the federal USF fund generate in 2003?**

Funding for universal service programs comes from payments by telecommunications carriers that provide interstate telecommunications services. In 2003, industry revenues from those services totaled about \$69 billion. Contributions to the USF totaled slightly less than \$6 billion that year, resulting in an overall contribution rate of 9 percent, up substantially from 2.7 percent in 1997. This increase in the contribution rate has come about because USF program costs have grown while the rate base has decreased.

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**How much money did the federal excise tax on telecommunications generate in 2003?**

The federal government levies a 3 percent excise tax on telecommunications. In fiscal year 2003, the federal government collected slightly less than \$6 billion in federal excise taxes on telecommunications.

If you wish further details on the information provided in this letter, we would be pleased to provide it. The staff contacts are Sarah Puro and Theresa Gullo.

Sincerely,

Douglas Holtz-Eakin  
Director

cc: Honorable John McCain  
Chairman  
Committee on Commerce,  
Science, and Transportation

Honorable Ernest F. Hollings  
Ranking Member

Honorable George Allen

Honorable Ron Wyden