

Jeanne Cochran, Legislative Analyst, 651-296-8961
Pat Dalton, Legislative Analyst, 651-296-7434

State Taxes and Fees Applicable to Voice, Video, and Data Service Providers

This information brief summarizes, in table form, state taxes and fees applicable to voice, video, and data service providers. It also provides background information on these taxes and fees.

Historically, the voice, video, and data services industries were separate industries providing separate services over dedicated facilities. Today, that is no longer true. In recent years, the voice, video, and data services industries, and the facilities they use to provide these services, have begun to converge. As a result, the intent of state tax policy regarding providers of voice, video, and data services is unclear. Is state tax policy intended to tax specific services, or is it intended to tax specific facilities used to provide these services? This information brief provides policymakers with information relevant to this question and to the question of whether the existing state taxes and fees applicable to voice, video, and data service providers need revision.

This information brief consists of:

- ▶ a discussion of convergence in the voice, video, and data services industries, why it is occurring, and why it matters from a legislative perspective;
- ▶ a table which presents the different state taxes and fees currently applicable to telecommunications, video, and data service providers; and
- ▶ background information on the applicable taxes, fees, and services.

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How Have the Voice, Video, and Data Services Industries Converged?

Not so long ago, telephone lines running into homes were used for only one purpose, to make telephone calls. Similarly, cable lines running into homes were used only for cable television services. Today, that is no longer true. Multiple services are now available over a single line. For example, in some areas of the country (including St. Cloud, Minnesota), it is possible to receive telephone, high-speed Internet access, and cable television service all over the same broadband cable wire. Traditional telephone lines are now commonly used both for voice communication and data transmission (i.e., Internet access). In addition, new technologies such as cellular telephones and digital satellites are also used to provide voice, video, and data transmission services which traditionally were provided only over land lines by a single purpose provider. These examples demonstrate how the voice, video, and data services markets are converging.

Why Is Convergence Occurring Now?

The convergence of the voice, video, and data services industries has been accelerating in the past few years. The recent increase in convergence is due largely to two factors: improved technology at a lower cost and changes in the regulation of these industries. The improvement in technology now makes it possible to transmit data effectively over an average telephone line and has allowed voice communications to be provided over cable networks and the Internet, as well as via cellular telephones. One of the most significant changes in technology is the transition from analog to digital transmission of voice, video, and data. In addition, changes in federal and state law have encouraged competition in the local and long distance telephone markets which were traditionally monopoly markets, as well as in the data services and video programming markets. Together these factors have facilitated the convergence of the voice, video, and data services markets.

Why Does Convergence Matter to Policymakers?

Because convergence has occurred fairly quickly in these industries, the existing statutory taxation and fee structure may not have kept up with changes in the industries. Many of the taxes and fees applicable to voice, video, and data services were established when each of these services was provided exclusively over a single line. Since then, these services have begun to be offered via multiple types of facilities. As a result, providers of the same service are in some cases now taxed differently depending on the technology used to provide the service. For that reason, policymakers may want to consider whether the state should tax the delivery system or the service delivered. Policymakers may also want to examine more generally whether the state taxes and fees applicable to voice, video, and data services need revision to reflect the convergence of these industries and the changes in technology.

In considering these issues, policymakers should be aware that in the not too distant future, voice, video, and data transmissions will be transmitted largely or wholly in digital form, meaning these three forms of communication will be indistinguishable while in the transmission pipe.¹ To assist in the analysis of these issues, the following table examines the taxes and fees that are applied to different providers of following services: local voice transmission, long distance voice transmission, video transmission, and data transmission. Background information on the state taxes, fees, and services covered by the table is included at the end.

The information in the following table is based on the assumption that the service is purchased separately. As part of the convergence of the voice, video, and data transmission industries, service providers are beginning to “bundle” various voice, video, and data transmission services together and charge one price for the entire package of services. It is hard to determine which taxes would apply to bundles of different services. In addition, the federal government has imposed a three-year moratorium on imposing new taxes on Internet access under the Internet Tax Freedom Act. For purposes of this act, “new taxes” includes existing taxes that were not imposed on Internet access prior to the enactment of the moratorium on October 1, 1998. It is unclear what taxes can be imposed on voice, video, or data transmission services that are sold as part of a package that includes Internet access.

Endnotes

1. Most data is transmitted in digital form today although data transmitted over traditional telephone lines via a dial-up modem at speeds up to 56Kbps is transmitted in analog form. Voice and video are still largely transmitted in analog form but can be (and are more frequently being) transmitted in digital form.
2. The table was prepared by House Research and Senate Tax Committee staff. Income taxes, property taxes, and sales taxes on inputs to industrial production apply uniformly to the various business entities covered by the table and therefore are not included.
3. Pursuant to the Department of Administration Order No. 181, the functions of the Department of Public Service relating to telephone companies are transferred to the Department of Commerce. Because this transfer was made by administrative order, the applicable statutes still refer to the Department of Public Service.
4. CLECs collect and remit the 911 surcharge to the Department of Administration but the law is unclear as to whether CLECs are required to do so.
5. See note 4.
6. See note 4.
7. Only on telephony portion of service if separately stated.
8. Capital equipment purchases made before May 5, 1993, by cellular service providers were taxed at a reduced rate as decided in the 1997 tax court case, *Minnesota RSA10 Ltd. Partnership v. Commissioner of Revenue*, 1996 WL 53858 (Minn. T.C. 1996). However, in 1993 the legislature limited the capital equipment exemption to equipment used in the production of tangible personal property for sale at retail. Therefore, equipment used in the provision of cellular telephone service no longer qualified for the reduced rate.
9. The assessment authority only applies to cellular companies in limited circumstances where they are seeking the jurisdiction of the PUC. Generally, cellular companies are not subject to the jurisdiction of the PUC.
10. Statutory exemption at Minnesota Statutes section 297A.2531.
11. Although tax is owed, it may be difficult to collect sales taxes due on satellite direct TV purchases. If the provider of the service has no equipment or personnel in the state (nexus), it cannot be forced to collect the state tax.
12. Minnesota Statutes section 297A.01, subdivision 3, paragraph (g), defines as taxable “[t]he furnishing for consideration of cable television services, including charges for basic service charges, for premium services, and any other charges for any other pay-per-view, monthly, or *similar television services*” (emphasis added). The Department of Revenue currently has no ruling whether video delivered over the Internet fits into this definition.
13. A local franchise fee is included under most franchise agreements but it is arguable whether cable companies are legally required to pay a franchise fee on Internet access over cable facilities.

Appendix A

Background Information on State Taxes and Fees and Voice, Video, and Data Service Providers Included in the Table

State Taxes and Fees

Capital Equipment Sales and Use Tax. The state generally exempts the purchase of capital equipment used in the production of tangible personal property from the state sales and use tax of 6.5 percent. However, this exemption does not extend to capital equipment used to produce most intangible products or services.

Customer Sales Tax. The general Minnesota sales and use tax of 6.5 percent paid by final purchasers of certain telecommunication services.

Local Franchise Fee. Under federal law, the local cable franchise fee amount is established by agreement between the local franchising authority and the cable company up to a maximum fee of 5 percent of annual gross receipts derived from operation of the cable system, to provide cable services. The maximum rate allowed is commonly the agreement rate.

911 Surcharge. This surcharge is imposed on local telephone users to fund the 911 and enhanced 911 emergency service system. Currently the monthly charge is \$0.27 for each telephone service capable of making a 911 call (including cellular).

PUC (Public Utilities Commission)/Commerce Operating Revenue Assessment. The general operating revenue assessment is collected through direct charges or indirect charges. Direct costs result from agency work activity created by a specific company or specified group of companies and the corresponding direct charges relate only to that company or group. Indirect costs result from agency activities which are not linked to a specific company or group and are allocated to all companies in the industry on the basis of company gross operating revenues. Both charges are subject to a cap: for direct charges, two-fifths of 1 percent of the gross jurisdictional operating revenues for all direct costs; for indirect costs, one-eighth of 1 percent of the total gross jurisdictional operating revenues for telephone companies, and one-sixth of 1 percent for energy utilities. These assessments recover regulatory costs incurred by the Public Utilities Commission, Department of Commerce, and the Office of Administrative Hearings (i.e., those which relate to commission proceedings).

TACIP Surcharge. This surcharge is imposed on local telephone users to fund the Telephone Access for Communication-Impaired Persons (TACIP) program, which provides funding for telecommunications relay service and equipment program for eligible communication-impaired persons. Currently the monthly charge is \$0.12 for each service capable of originating a telecommunications relay call (including cellular).

TAP Surcharge. The Telephone Assistance Program (TAP) surcharge is imposed on local telephone access lines (land lines only, not cellular) to provide financial assistance to low-income

elderly and disabled persons for basic telephone service. Currently, the monthly charge is \$0.06 per access line. The 911, TAP, and TACIP surcharges for each line are combined and appear as a single surcharge on the customer's bill.

Local Voice Service

Cable Telephony. Telephone service provided over facilities which are traditionally used for cable television service.

Cellular Telephone Service. Radio telephone service which uses multiple transceiver sites, called "cells," to transmit and receive signals to and from telephones within a cell. The user is transferred from one cell to another as the user moves between areas. When a cellular call is made, the call is transmitted to the cell which connects the call to a central switching office. From there, the call is connected to the person being called.

CLEC Reseller. A CLEC which offers local telephone service by reselling the services of the ILEC.

Competitive Local Exchange Carrier (CLEC). A company which competes for local telephone business with the ILEC.

Facilities-based CLEC. A CLEC which offers local telephone service using its own telecommunications facilities.

Incumbent Local Exchange Carrier (ILEC). The established local telephone company that provided service in an area before local telephone competition was permitted by law.

Long Distance Service

Traditional Long Distance. Telephone service for calls outside the local telephone service calling area. A toll charge generally applies to long distance calls.

Two-way Voice over the Internet. Voice communication between two users over the Internet, rather than over the traditional telephone network.

Video Service

Cable Television Service. Multiple station television service provided over a coaxial cable wire running into the customer's home.

Satellite Television Service. Multiple station television service provided via satellite transmission.

Video over the Internet. On demand video programming service provided over the Internet.

Data Transmission Service

Cable Internet Access. Internet access and data transmission services via a coaxial cable running into the home, traditionally used for cable television service, at speeds greater than are available with a traditional dial-up modem over a traditional telephone line.

High-speed Digital Subscriber Services over Telephone Lines. Data transmission and Internet access services over traditional telephone lines at speeds greater than are available with a traditional dial-up modem over a traditional telephone line.

Satellite Internet Access. Internet access and data transmission service via satellite, at speeds greater than are available with a traditional dial-up modem over a traditional telephone line.

Wide-area Network. A communications network that connects geographically separate areas.