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A Revenue Analysis of Virginia Communications Tax Reform

by Scott Mackey

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Overview

Communications tax reform has been discussed by the communications industry; state legislators; and national, state, and local government organizations for more than a decade. In fact, most policymakers and tax experts agree that communications taxes should be reformed to lower the overall burden on users of communications services and to ensure those services are taxed in a competitively neutral manner. One stumbling block to reform has been local governments' concerns that reforms that take away their direct taxing authority would reduce local revenue because the states would not meet their commitments to replace lost revenues.

For that and other reasons, despite agreement that reform is long overdue, only a handful of states have undertaken communications tax reform, and only Virginia has enacted comprehensive reform. This report explores the consequences of the Virginia reform for Virginia governments, the industry, and consumers.

This analysis concludes that local governments in Virginia have received more money under the communication services tax (CST) than they would have received under the previous law. The Virginia CST has provided stable revenues for local governments while relieving consumers from excessive tax rates on certain types of telecommunications services. It appears that the CST reform has been win-win for consumers and governments.

The Virginia CST reform bill was signed into law as Chapter 780, Laws 2006 on April 6, 2006, and became effective for communications services provided on or after January 1, 2007. It replaced a hodgepodge of state and local taxes on cable programming services, wireline telecommunications service, and wireless telecommunications service with a new statewide communications services tax levied at the same 5 percent tax rate as the combined state-local sales and use tax rate. Also, a modest-cost-based, state-administered right-of-way fee was imposed on telecommunications and cable programming providers that place equipment in the public right-of-way. Finally, the reform imposed an additional statewide 911 fee on wireless and wireline telecommunications (including Voice over Internet Protocol) to fund the statewide emergency communications system.

> ***Local governments in Virginia have received more money under the communication services tax than they would have received under the previous law.***

Before enactment of the CST reform, consumers faced a myriad of state and local taxes and fees on communications services. Wireline telecommunications were subject to local franchise fees, local consumer utility taxes, and 911 fees that were among the highest in the nation, comprising nearly 30 percent of the local phone bill. Interstate long-distance charges, if separately stated, were exempt from taxation. Wireless telephone service was subject to a local $3 monthly tax on each bill in most local jurisdictions. Cable video programming service was subject to a local franchise fee of up to 5 percent of the monthly bill, while satellite video programming was exempt from all state and local taxes.

As other states look to reform their antiquated taxes on communications services, they would be well served to study the Virginia reform model. CST reform in Virginia proved that a broad-based tax system with low rates can produce stable, sustainable revenue for governments without the inherent economic distortions that flow from antiquated tax structures with high rates and narrow bases.

Table 1.
Revenue Flows Before and After CST Reform

Revenue Source	Prior Law	Communications Services Tax
Local Consumer Utility Tax — Wireline	Imposed Locally	Repealed
Local Consumer Utility Tax — Wireless	Imposed Locally	Repealed
911 Fee — Wireline	Imposed Locally	Imposed Statewide
911 Fee — Wireless	Imposed Statewide	Imposed Statewide
Franchise / Right-of-Way Fee — Telecom	Imposed Locally	Repealed
Franchise/ Right-of-Way Fee — Video	Imposed Locally	Repealed
Communications Services Tax	Not Imposed	Imposed Statewide

Table 2.
Local Revenue from Utility and Communications Taxes, Fiscal 2006 to Fiscal 2009 ($s millions)

Fiscal Year	Local CST Revenue	Adjusted Local CST Revenue*	Local Utility Tax (LCUT) Revenue	Local 911 Tax Revenue	Local Franchise Fee/Tax	Total Local Revenue (adjusted)*
Fiscal 2006	$0	$0	$550.3	$110.9	$65.5	**$726.7**
Fiscal 2007	$172.3	$172.3	$438.8	$66.1	$50.8	**$728.1**
Fiscal 2008	$441.0	$419.9	$309.2	$0	$22.2	**$751.3**
Fiscal 2009	$403.3	$424.5	$310.6	$0	$25.6	**$760.8**

Source: Virginia Auditor of Public Accounts.
*Adjusted revenue includes a reallocation of revenues from fiscal 2008 because of a provider overpayment in fiscal 2008 that was refunded in fiscal 2009.

Revenue Analysis

The CST law included a provision that required that local governments receive the same amount of money in the first year of enactment that they would have received under the previous law. To ensure that this requirement was met, the law required local governments to report their actual collections to the auditor of public accounts so that a baseline revenue amount could be calculated. By all accounts, the law was effective in guaranteeing that this local revenue hold harmless provision was met. However, to assess the effect of the new law in later years, it is necessary to make assumptions about what revenue would have accrued to local governments under the old law.

Fortunately, the Virginia auditor of public accounts has an extensive database of local revenues received by every local government in Virginia.[1] Using publicly available data from the auditor's website, it is possible to estimate revenue flows before and after the passage of the CST reform in Virginia. Table 1 summarizes the revenue sources for state and local governments in Virginia before and after passage of the reform.

As noted in Table 1, the local consumer utility taxes (LCUT) and the local franchise fees on communications services were repealed and replaced by the CST. Because both those taxes included revenue from communications providers and non-communications utilities alike, it was necessary to disaggregate the revenue from communications services from total revenues. Table 2 shows the local revenue from these two revenue sources before and after passage of the CST legislation. Since the legislation took effect on January 1, 2007, the fiscal year impact in fiscal 2007 reflects only five months of CST collections and seven months of LCUT and franchise tax revenue.

Table 3 shows local revenues from communications services only, by isolating the communications portion of the repealed franchise and utility taxes. It assumes that the baseline utility tax revenue from fiscal 2008 in Table 2, after repeal of the LCUT on communications service, is the amount of revenue received from utilities other than communications. That baseline amount was subtracted from total collections in fiscal 2006 to isolate the amount of LCUT communications service tax revenue replaced by the CST, a total of about $241 million annually. The same method was used to estimate franchise fee revenue from non-communications sources, a total of about $43.3 million annually. In total, the law repealed about $395 million in local communications taxes in its first full year of implementation.

To compare the fiscal 2008 and fiscal 2009 actual CST revenue to what would have been raised under

[1]*Available at* http://www.apa.virginia.gov/LocalGovernment/ComparativeReportarchive .cfm.

Table 3.
Local Revenue from Communications Taxes Only, Fiscal 2006 to Fiscal 2009 ($s millions)

Fiscal Year	Local CST Revenue	Adjusted Local CST Revenue*	Local Utility Tax Revenue	Local 911 Tax Revenue	Local Franchise Fee/Tax	Total Local Revenue (adjusted)*
Fiscal 2006	$0	$0	$241.1	$110.9	$43.3	**$395.3**
Fiscal 2007	$172.3	$172.3	$129.6	$66.1	$28.7	**$396.7**
Fiscal 2008	$441.0	$419.9	$0	$0	$0	**$419.9**
Fiscal 2009	$403.3	$424.5	$0	$0	$0	**$424.5**

Source: Virginia Auditor of Public Accounts.
*Adjusted revenue includes a reallocation of $21.1 million from fiscal 2008 to fiscal 2009 because of a provider overpayment in fiscal 2008 that was refunded in fiscal 2009.

Table 4.
Estimated Wireline Revenues Under Prior Law

Fiscal Year	Wireline Connec-tions*	Estimated Annual LCUT Revenue/ Line	Estimated LCUT Revenue ($s millions)	Estimated Local 911 Revenue ($s millions)	Estimated Local Franchise Revenue ($s millions)	Total Actual /Estimated Revenue ($s millions)
Fiscal 2006	4,843,650	$27.57	$133.5	$110.6	$42.5	**$286.6**
Fiscal 2007	4,510,839	$27.57	$124.4	$102.1	$39.6	**$266.0**
Fiscal 2008	4,403,850	$27.57	$121.4	$99.6	$38.6	**$259.7**
Fiscal 2009	4,190,174	$27.57	$115.5	$94.8	$36.7	**$247.1**
Fiscal 2010	4,022,567E**	$27.57	$110.9	$91.0	$35.3	**$237.2**

*Virginia State Corporation Commission
**E stands for "estimated."

the previous law, it is necessary to make some assumptions about how changes in the communications service marketplace would have affected revenues under the old tax regime. Critical data to perform this analysis include an estimate of the total line losses for wireline service, the growth in wireless subscribership, and the number of wireless subscribers per billed account.

The State Corporation Commission provided actual numbers of wireline connections through 2009. Unsurprisingly, those figures showed significant line losses for landline service. The Virginia numbers are consistent with national trends showing continued reductions in landline numbers, with an acceleration of landline losses in 2009 due to the recession.[2] Using actual revenue collections from 2006, the average LCUT revenue per landline of $27.57 per year was used to estimate the revenue loss to local governments that would have occurred under the old law due to landline line losses. For local 911 and franchise fee revenues, revenue losses were estimated to track the percentage declines in wireline connections as well. The estimate shows that revenues from landline-based taxes would have declined from $286.6 million in fiscal 2006 to an estimated $237.2 million in fiscal 2010 absent changes in existing tax rates. Those numbers are provided in Table 4.

A similar method was used to estimate the change in revenue from wireless service that would have occurred under the old law. Market factors would suggest that the loss in landline revenues would be offset by growth in wireless subscribership. However, because the LCUT on wireless was capped at $3 per bill, local governments would not have experienced revenue growth in proportion to the total number of new wireless lines that were added throughout the period because of the growing popularity of family share plans. (Under this method, the number of wireless lines per customer bill is assumed to increase from 1.5 in 2006 to 1.75 in 2010.) Also, the growth in prepaid wireless subscribers would also reduce LCUT revenues because prepaid service is subject to the state sales and use tax and not the LCUT under prior law. Estimated wireless revenues under the old law are shown in Table 5 (see next page).

Table 6 compares actual collections from the CST to the estimate of the revenues that would have been

[2]See the FCC, "Local Telephone Competition Report," *available at* at http://www.fcc.gov/Daily_Releases/Daily_Business/2011/db0111/DOC-304054A1.pdf.

Table 5.
Estimated Wireless Revenues Under Prior Law

Fiscal Year	All Wireless Subscribers*	Less: Estimated Prepaid Subscribers	Estimated Postpaid Subscribers	Estimated Billed Accounts	Tax Per Bill @ $3.00 Monthly Cap	Estimated Wireless LCUT Revenue ($s millions)
Fiscal 2006	5,235,173	680,572	4,554,601	2,986,854	$36.00	**$107.5**
Fiscal 2007	6,148,261	964,047	5,184,214	3,266,055	$36.00	**$117.6**
Fiscal 2008	6,242,155	1,054,924	5,187,231	3,164,211	$36.00	**$113.9**
Fiscal 2009	6,596,000	1,266,432	5,329,568	3,144,445	$36.00	**$113.2**
Fiscal 2010	7,250,000	1,486,250	5,763,750	3,285,338	$36.00	**$118.3**

*FCC Local Telephone Competition Report.
**Based on CTIA national prepaid estimates.

Table 6.
Local Revenues Under CST Compared With Prior Law

Fiscal Year	Communications Services Tax Revenues	Estimated Communications Revenues Under Prior Law	CST Reform Over / Under Prior Law
Fiscal 2006	$0	$393.2	**NA**
Fiscal 2007	$413.6	$383.6	**$30.0**
Fiscal 2008	$419.9	$373.6	**$46.3**
Fiscal 2009	$424.5	$360.3	**$64.2**
Fiscal 2010E**	$407.8E	$355.5E	**$52.3E**

**E stands for "estimated."

raised under the old law. This analysis concludes that local governments have received nearly $200 million in revenues that they would not have received under the old law.

Conclusion

Local governments have benefited significantly from the communications services tax reform in Virginia. The CST legislation broadened the tax base, lowered rates on most services, and allowed local governments to avoid revenue reductions that would have occurred had the old tax system remained in place.

The CST reform benefits for local governments have not come at the expense of Virginia consumers. In fact, communications consumers in Virginia enjoy some of the lowest taxes on communications services of any state in the nation. For example, a new study of wireless tax burdens shows that Virginia ranked 44th (low ranking = low taxes) in overall tax burden on wireless services.[3] Consumers of cable video service similarly face low tax burdens because, unlike some other states, Virginia does not impose both a franchise fee and a sales tax on video programming service. Although the reform required consumers of satellite video programming services to pay taxes on that service, Virginia's rate of 5 percent is among the lowest of any state that imposes a tax on satellite video programming services.

One of the major impediments to communications tax reform in the states has been the concerns expressed by local governments that they would not only lose revenue, but also lose autonomy over an important local revenue source. On the first issue, Virginia clearly shows that it is possible to reform the tax structure in a way that protects the tax base. On the second issue, the Virginia General Assembly, despite facing severe budget pressures during the last two legislative sessions, has not raided CST revenue for state purposes.

For states looking to reform taxation of communications service, the Virginia CST law is a model for successful reform. ✰

[3]Scott Mackey, "A Growing Burden: Taxes, Fees, and Government Charges on Wireless," *State Tax Notes*, Feb. 14, 2011, p. 475, *Doc 2011-1122*, or *2011 STT 30-1*.