The Contemporary Tax Journal

Volume 1
Issue 2 *Summer 2011*

Article 7

6-2011

Repeal of Federal Telephone Excise Tax

Sandra Peters

Repeal of Federal Telephone Excise Tax

By: Sandra Peters, *MST Student*

The federal excise tax on telephone use (IRC Section 4251) began in 1898 as one of many excise taxes enacted to raise revenue for the Spanish-American War. The tax has been repealed, reinstated, expired, extended and changed. It was made permanent in 1990. It has outlived its original intent yet has stayed to provide revenue for the general fund.

Many sessions of Congress have looked at its repeal in the last decade. The current proposal in the 112th Congress is H.R. 428 which again attempts to repeal the tax. The policy analysis below uses the ten principles of good tax policy outlined in the AICPA Statement #1, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposal*. Each of the ten principles is considered in respect to the existing law.

For additional information on the telephone excise tax and its application and economic effects, see *The Telephone Excise Tax: An Economic Analysis*, by Steven Maguire and Brent W. Mast, Congressional Research Service, June 2006; available at http://www.policyarchive.org/handle/10207/bitstreams/2810.pdf.

Principles of Good Tax Policy Evaluation

Principle	Application	Rating
Equity and Fairness Similarly situated taxpayers treated similarly.	The telephone excise tax does treat similar taxpayers equally. The tax would be roughly the same for two taxpayers with similar income and consumption. The consumption or variation in local calls for similar taxpayers would be the same. Before the exclusion of long distance calls from the tax, the horizontal equity may have been less. Taxpayers in the same income bracket could be taxed differently based on need for long distance calling. Vertical equity is not achieved since taxpayers of all income levels are taxed at the same rate. The tax is regressive as it does not take into account an ability to pay and the percent of income used to pay this tax is greater for the lower income taxpayers. Changes in technology can create inequity in that some types of Internet based calling may not meet the definition of communications services subject to the excise tax.	**Vertical –** **Horizontal +**

Certainty The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.	The fact that the tax will appear on a taxpayer's service bill is certain, but how it is determined is not visible to the taxpayer. It is also clear that the payment is due with the payment for services. It is not clear to the taxpayer when it is actually remitted to the government. Taxpayers know when it is due to the provider, not necessarily the government. The certainty for the service provider may be obscured by rules regarding the separation of services into taxable local calls and other services. There are also exclusions and exceptions such as those for schools. There are special calculations for non-standard local calls such as pay phones or prepaid cards; this decreases certainty.	-
Convenience of Payment A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.	The telephone excise tax is conveniently paid by the taxpayer when making payment for the communication service. It requires no special forms or calculations for the consumer. The communication provider however, must properly calculate and pay at a minimum every quarter by filing an excise tax return. There is convenience to the taxpayer but not necessarily to the remitter of the tax. The tax is in effect collected by a third party, similar to a retailer's collection of sales tax.	+
Economy in Collection The costs to collect a tax should be kept to a minimum for both the government and taxpayers.	The cost to collect this tax is minimal because it is collected by the service provider rather than by all users. The provider may have costs to properly identify and assess the amount due but from the government's perspective, costs are minimal. Collection costs are minimal for the service provider as customers are motivated to pay their bills to avoid service interruption. Any IRS collection costs to collect from the provider would be minimal since there are few remitters of the tax.	+

Simplicity The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.	Taxpayers may not understand the tax or rules but the compliance is cost-efficient since the tax is not self-assessed like an income tax. The calculation of amount owed is simple to the consumer but may be more complex to the service provider. The complexity to the service provider is due to exceptions and definitional issues. Many years ago telephone companies were the only providers of telecommunications and phone services were limited to local and long distance voice calls. With the changes to technology, telecommunications may be provided by or bundled with other services such as Internet or cable. Broadband technology allows a phone line to be used for other than voice. As technology rapidly changes, the definitions of what is taxed and how it is separated out from other "line" uses will need constant re-evaluation. Some local voice calls may actually not even use a phone company at all, utilizing voice over Internet technology. Someday, local calls may also be eliminated as we move toward replacing calls with email, messaging and other forms of communication. There is concern that this will lead to an expansion of the tax to include other communication, not just local voice calls from phone companies. Out of context, this tax appears simple yet it contributes to overall tax complexity. It is a layer of tax added to income taxes, sales tax and a multitude of "other taxes" which together form a web of complexity not always visible to the final consumer.	**-**
Neutrality The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.	The telephone tax is based on local calls and some would argue that this type of communication is a necessity in today's society. Access to emergency help and connection to the society is as necessary as electricity and plumbing. In this regard, the demand is relatively inelastic in an economic sense, meaning an increased cost does not mean a decrease in demand. Consumers are somewhat limited in choices if the tax were too high; behavior is not likely to change, whether or not there is a tax. A tax on talking is not likely to limit talking. Before the law change to exclude long distance calls, a consumer may have chosen a provider that used a flat rate for all calls. Business consumers may have more choices in structuring	**-**

	communications to reduce the tax. The tax may not be neutral in its effect on the service provider. The provider may choose to find non-taxable communication services as an alternative to the defined local call for which more options are rapidly evolving. In today's technology, not all communications are subject to the tax.	
Economic Growth and Efficiency The tax system should not impede or reduce the productive capacity of the economy.	Taxes affect how resources are used. It affects the return on investment and contributes to barriers of entry in some markets. The fact that the tax increases the cost of service may affect the use of capital. Technology could be diverted to finding non-taxable alternatives.	**-**
Transparency and Visibility Taxpayers should know that a tax exists and how and when it is imposed upon them and others.	It is not likely that most taxpayers know that the tax exists unless they carefully review their communications bill. Even when separately stated, it is not likely that it is understood or how it is calculated or how it could be avoided. One of the reasons the tax has eluded reform is that it is not very visible and thus, is hidden from scrutiny. It is not likely the average person even knows that it is paid to the IRS or funds the federal government. Some taxpayers might assume it is a fee paid to the phone company similar to a user fee.	**-**
Minimum Tax Gap A tax should be structured to minimize non-compliance.	With the tax assessed upon the service providers rather than self-assessed by millions of users, the tax gap is likely minimal for the telephone excise tax. Yet, there may be a gap in compliance by communication providers due to complexities, exclusions, and misunderstood regulations.	**+**
Appropriate government revenues The tax system should enable	The collection of this tax has been relatively stable and predictable over the last decade. Consumer behavior and economic turmoil will not likely significantly change the amount since it is based on an inelastic commodity. There would be some change based simply on population expansion.	**+**

the government to determine how much tax revenue will likely be collected and when.	Business expansion or additional phone lines may increase the tax. During down economies, the tax should still remain constant as consumers are not likely to change their behavior.	

Conclusion

There is little argument that the existing telephone excise tax would qualify as good policy in regard to horizontal equity, convenience of payment, economy of collection, and minimum tax gap. These principles alone though do not qualify the tax as good policy.

The Institute for Research on the Economics of Taxation (IRET) stated in a 1999 paper: "Government revenues should be collected through broad, non-distorting taxes, not through selective excise taxes."[24] The current tax is one additional layer of tax that goes unnoticed yet contributes to the overall complexity of our tax system as a whole. The telephone excise tax should be repealed as part of tax reform to obtain simplicity, transparency, and visibility. In addition, the revenue the tax generates is minimal and its base and structure are based on 20th century ways of telecommunications and are thus outdated for today's economy and technology.

[24] IRET, Policy Bulletin No. 74 February 2, 1999 – *Taxing Talk: The Telephone Excise Tax and Universal Service Fees,,* page 14; available at http://iret.org/pub/BLTN-74.PDF