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STUDY: STATE, LOCAL TAXATION OF DSL INTERNET ACCESS WOULD SLASH UNIVERSAL SERVICE FUND, HURT ECONOMY

$280 Million in Losses Seen Over Five Years to Federal Universal Service Fund; Industry Would Lose $4 Billion in Funds For Investment in Jobs, Broadband.

WASHINGTON, D.C.///April 26, 2004/// – The imposition of state and local telecommunications taxes on digital subscriber line (DSL) services would slash federal Universal Service Fund (USF) contributions by $280 million and lead to $4.3 billion in reduced industry revenues available for investment in new union jobs and expanded availability of broadband technologies, according to a new study released today by the New Millennium Research Council (NMRC). The U.S. Senate is poised to debate this week the issue of state and local taxation of Internet access.

The NMRC study, "*Taxing High-Speed Services: A Quantification of the Effects on the DSL Industry and Universal Service,*" was written by economist Stephen Pociask, a seated NMRC scholar. Pociask is president of TeleNomic Research, a consulting firm specializing in public policy analysis for information technology industries.

Pociask said: "DSL service is price-sensitive and an increase in taxes would produce an increase in price, leading to a significant reduction in demand and a decrease in total industry revenues." He explained that consumers would migrate to tax-exempt cable-modem service, or abandon high-speed access altogether. "Since cable operators do not pay into the Universal Service Fund, an increase in cable-modem demand would not help state and local governments raise taxes nor would it help fund universal service programs."

USF **c**ontributions are paid on all interstate telecommunications services and are used to support telecom service for low income customers, underwrite network development in high-cost areas, and fund Internet services for schools, libraries, and rural healthcare providers. Pociask warned: "Because universal service programs are already under financial strain, this substantial contribution loss would put these social programs in serious jeopardy."

Diminished industry revenues would reduce investment in DSL deployment, curtail union job growth, and deny states potential employment, property, and income taxes associated with the economic stimulus of broadband technologies. The NMRC study estimates that the reduction in industry revenues would lead to a one-year loss of 11,900 direct jobs, including 7,600 unionized jobs. There also would be a sizable loss of jobs in other industries, according to Pociask.

The U.S. Senate is expected to take up this week the question of state and local taxes on Internet access. One bill, S. 150, calls for a permanent ban on taxation of Internet access and services and broadens the definition to include DSL and wireless platforms in addition to cable-modem service. Another, S. 2084, would only extend a now-expired moratorium on state and local taxation of cable-modem service by two years, but leave consumers using DSL or wireless platforms paying state and local taxes.

Congress passed a temporary moratorium in 1998, with language restricted to cable-modem service because DSL was just developing at the time. Last fall, the House of Representatives passed a bill making the tax ban permanent and including the newer technology platforms. Because the Senate could not reach a vote before the end of session, the moratorium expired.

The NMRC study explores two scenarios: one with a DSL tax rate of 10.9 percent (the difference between average taxes of 16.9 percent for telecommunications services and the average general business tax of 6 percent); the other with a tax rate of 16.9 percent for cases where a tax exemption has existed previously.

In both cases, Pociask anticipates a reduction in high-speed DSL growth over five years due to suppressed demand caused by tax-fueled price increases as well as eventual market saturation. In the first scenario, DSL revenue loss over five years would be $2.5 billion with a USF shortfall of $161 million. In the second scenario, DSL revenue loss over five years would be $4.3 billion and USF support is depleted by $280 million.

By contrast, the Congressional Budget Office estimates that the cost today of making the moratorium permanent across all platforms and ending current state and local taxation of DSL service would be only $40 million. Pociask noted: "If state and local taxes are prohibited, the risk to state and local budgets is very small compared to what they currently spend."

The study author highlights several additional adverse effects of Internet taxation: stunting the widespread deployment of broadband services and thereby slowing the pace of technological change; driving consumers off of high-speed networks, with serious effects on the health of the overall economy (information technology investments to date have been instrumental in stimulating economic growth and productivity); and increasing highway congestion, gasoline consumption and air pollution through the loss of e-commerce and a reduction in the growth of work-at-home businesses.

ABOUT NMRC

Established in 1999, the New Millennium Research Council (NMRC) is composed of a network of policy experts who develop workable, real-world solutions to the issues and challenges confronting policy makers. Its work has focused primarily in the fields of telecommunications and technology. For more information on the NMRC please visit: http://www.newmillenniumresearch.org

NOTE: You can hear a Web-based replay of this news event as of 4 p.m. EDT today at http://www.newmillenniumresearch.org. The NMRC study and this news release will be available at the same URL.

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