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TO: The South Carolina Tax Realignment Commission

FROM: Ted Creech, AT&T South Carolina

RE: Taxes and the Telecommunications Industry and Its Customers

As the South Carolina Tax Realignment Commission examines a variety of state tax matters, including the some 80 state sales tax exemptions, AT&T appreciates the opportunity to provide the Commission with a very basic overview of tax policy as it relates to the telecommunications industry and our customers.

AT&T has significant interest in taxes that impact general business, such as property taxes, payroll taxes and business license taxes, and we anticipate that we will agree with much of what is likely to be stated by other members of the business community about taxation and the need for comprehensive tax reform. For the purposes of this letter, however, we focus on taxation that affects the telecommunications industry and its customers, specifically.

AT&T supports modernizing telecommunications tax laws based on such principles as equity, efficiency and attracting businesses and individuals to locate in South Carolina. Such modernization, however, should result in broad telecom tax reform and should not be limited to a simple change in one tax exemption or another.

As always, tax reform efforts should consider the tax structure of states we compete with in attracting businesses and individuals to locate in South Carolina. Below is an overview of our state as well as some other states in the Southeast.

Current Telecommunications Tax Structure – South Carolina

In addition to the general taxes paid by businesses and their customers (e.g., property taxes, income taxes, sales and use taxes), there are special taxes and fees imposed upon the telecommunications industry and its customers at the state and local levels. For example, in addition to the 3% federal excise tax on local service and regulatory fees, South Carolina and its political subdivisions impose the following taxes and fees which are separately stated on customers' bills:

- Municipal Business License Taxes – 1% gross receipts tax on all telecom services.

- Video Franchise Fees – up to 5% of gross receipts on video services.
- E911 Fees – varies by jurisdiction but can be as high as \$1.50 per month
- Telecommunications Relay Service -- \$0.15 per month.

In addition, customers also pay State and Federal Universal Service Fund charges that support the price of basic local service, especially in high-cost, rural areas. Local exchange companies also pay fees for the operating expenses of the Public Service Commission and Office of Regulatory Staff.

The Business Case for Maintaining the Current Tax Environment – Georgia

Georgia's telecommunications tax structure is very similar to South Carolina's. Only local telecommunications service is subject to Georgia state sales tax, and many of the municipalities impose a local franchise fee on local recurring service (similar to South Carolina's Municipal Business License Tax – a gross receipts tax). As a result, Georgia, like South Carolina, attracts businesses and business operations that rely heavily on telecommunications, such as call centers and technology intensive businesses. For example, telecommunications services represent a significant cost to call center operations as they receive and place long distance calls during virtually every second of operation. South Carolina's sales tax exemption on long distance is an important factor when enterprises consider where they might place a call center operation, which could bring hundreds or even a thousand or more jobs to the state. Our state's long distance exemption keeps us competitive with Georgia and gives us a competitive advantage over other states that do not have a long distance sales tax exemption.

Other Southeastern State Tax Reforms

Over the years more and more states are taxing long distance service, but often as part of overall telecom tax reform. In Louisiana, Tennessee and Mississippi, the sales tax base expansion was used to off-set the extremely high property tax assessment ratios imposed upon local exchange carriers that were not imposed upon other communications companies or on general businesses. In some instances, the excessive property tax assessment ratios doubled the amount of property taxes paid by local exchange carriers as compared to general businesses. This discouraged infrastructure investments in these states. The tax on interstate services (long distance) was used to mitigate the impact of the investment disincentives created by excessive property taxes. Similarly, Florida combined a myriad of state and local communications taxes and replaced them with a broad-based communications services tax. The base expansion included taxing interstate services. The effect was a reduction of the overall tax rates charged to taxpayers on communications services. All of these tax reforms have been revenue neutral and designed to improve the state's ability to attract technology investments.

Model Communications Tax Reform – North Carolina

Throughout the nation, North Carolina is viewed as the model communications tax reform state as telecommunications in North Carolina is now taxed more like general business. Some components of North Carolina's tax reforms have had negative revenue impacts while others have had positive revenue impacts, but North Carolina's reforms have always been based on the overall goal of sound fiscal policy, recognizing the convergence of technologies in the industry, promoting infrastructure investment, keeping local governments whole, and taxing the industry as other businesses are taxed.

This was accomplished by repealing utility-type taxes/fees, expanding the state's machinery single article rate to a full machinery sales tax exemption, and broadening its sales tax base to include interstate services. The final result of North Carolina's effort is that all communications services are subject to a general sales tax. There is no pyramiding of taxes (taxing business inputs *and* their outputs) because the purchase of network equipment used to provide communications service is not subject to tax. Lastly, local government funding that was previously generated by franchise taxes/fees was replaced by the broad-based sales tax that kept local jurisdictions whole but simplified the tax structure and administration.

Telecommunications Tax Reform Considerations

If the Commission contemplates tax changes in telecommunications, we believe it should consider the following:

- developing language that avoids Constitutional issues inherent in taxing interstate services;
- providing administrative clarity in taxing of complex communications services;
- reviewing the current statutes and amending them if necessary to ensure that the sourcing of revenue between states would be done in a fair and equitable manner;
- reviewing the statutes to ensure full compliance with the federal mobile sourcing act;
- avoiding the pyramiding of taxes; and
- Providing equipment incentives (or removing disincentives) to maximize the positive impact of network equipment budgets in the industry's ongoing effort to provide the citizens of South Carolina the most advanced communications services.

At a minimum, AT&T recommends the following if long distance services are taxed:

- Adopt the latest uniform telecommunications definitions from the Streamline Sales Tax Project (SSTP) agreement.
- Adopt the latest SSTP's telecommunications sourcing rules if needed. Sourcing rules determine which states charge a provider or customer taxes when a telecommunications service involves multiple states. These are standard rules developed by state administrators and the telecommunications industry and based on long-standing court decisions (e.g., the two-out-of-three rule when taxing interstate services).
- Adopt a special exception for call centers. An across-the-board sales tax on long distance would be detrimental to all businesses that use long distance services, but especially businesses like call centers that rely significantly on telecommunications. Call centers provide broad-based employment, ranging from entry-level to sophisticated knowledge-worker positions. Many states that tax interstate services provide for a cap on sales tax paid by call centers. This is normally accomplished by using a direct pay permit whereby the call centers remit the capped tax directly. Call centers often use multiple telecommunications providers, rendering each provider unable to track and implement caps for their call center customers effectively.
- Avoid pyramiding of taxes by allowing network equipment to be exempt from tax. A guiding principle of sales tax is that the tax is imposed on the final sale of a finished product or service. The inputs, including labor and material used to produce the product, are not taxed. Likewise,

manufacturing equipment, cable TV network equipment and other machinery used to make products are also not subject to tax. We believe tax pyramiding is not sound public policy. If long distance services (intrastate, interstate and international) are subject to South Carolina sales tax, then South Carolina's manufacturing machinery exemption should be extended to include equipment to produce telecommunications services.

-- Allowing network equipment to be purchased without tax will also benefit our citizens because budgets for capital expenditures will go farther in allowing telecommunications providers to build out their South Carolina networks with the most advanced technologies. Expanding the machinery exemption will make South Carolina more competitive in attracting communications infrastructure investments. A survey of site location professionals ranked telecommunications capacity as the third key consideration for businesses locating within a state (skilled labor and access to transportation were the first and second key considerations respectively).

We hope you will agree that tax modernization is more than just repealing exemptions, but an opportunity to establish public tax policy that is equitable, efficient and able to attract businesses and individuals to locate in the state. AT&T applauds your efforts to this end and is ready to assist you as you deem necessary.

Sincerely,



Ted Creech