CHANGING COMMUNICATIONS LANDSCAPE RAISES TAXING QUESTIONS

Revenue from the state tax on telephone company property sank last year to its lowest level since the 1970s, a reflection of a shifting telecommunications landscape and a series of tax changes over time. Now, a recently adopted state law will almost eliminate the tax, which takes the place of local property taxes on telephone companies. Proponents say this approach makes sense in a world where traditional monopolies no longer hold sway, and levels the playing field now that the state has ended a related tax on other businesses.

Telecommunications companies paid the state of Wisconsin just over $50 million in telephone taxes in 2023, a 26.6% drop from the prior year and less than one-third of peak collections in 1997. The fall in telephone tax revenues isn't finished; a 2024 law will lower collections to an estimated $5 million by 2027 and beyond (see Figure 1).

The new law follows changes to local property taxes levied on other industries and reduces to a modest amount a tax that generated more than $300 million a year in inflation-adjusted revenue at its height during the 1990s. It reflects shifts in both how state leaders view the telecommunications industry as well as in Wisconsin's approach to taxes.

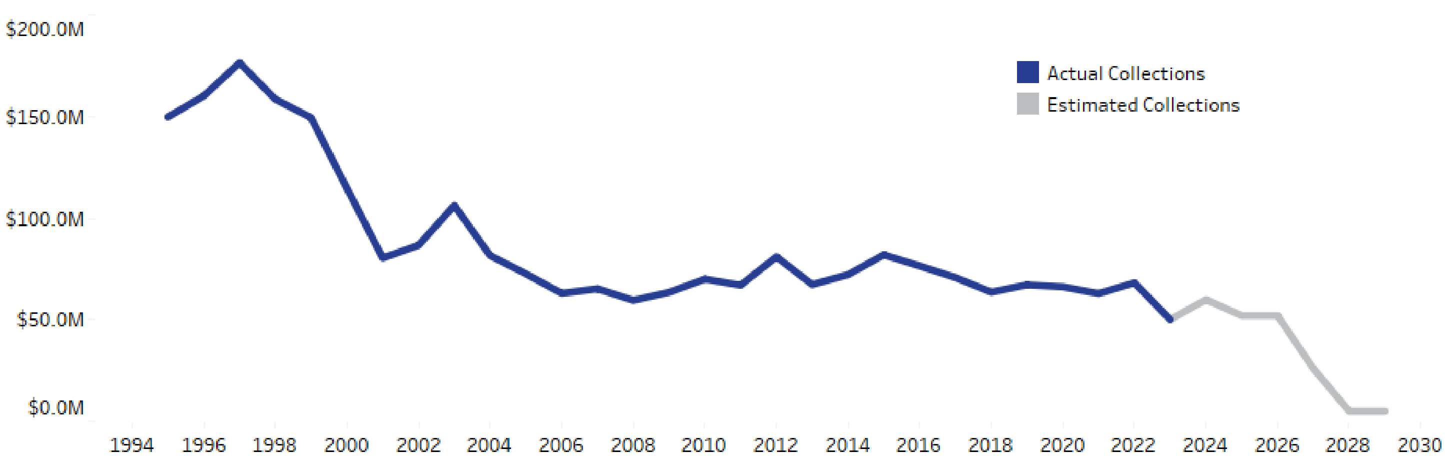
Traditionally, telephone taxes in Wisconsin served as a form of state tax on the land and property owned by utilities. They were created at a time when the telephone was the fastest and easiest way to contact someone far away, and when consumers typically had no choice about their service provider. But other forms of communication such as cell phones, voice over internet phones, email, and instant messages have contributed over time to a decline in traditional phone service, to the point that only a quarter of people nationwide still live in households with landlines.

These changes have made the market for long distance communication more competitive, as landline service companies also compete with other providers of electronic communication, such as cable companies that traditionally have been taxed differently.

State leaders have changed Wisconsin tax law, trying to keep up with rapid technological changes. Yet the state

Figure 1: Telephone Tax Revenue Has Declined Substantially Since the Mid-1990s

Total telephone utility tax revenue collected by year, 1994-2029 (not adjusted for inflation)



Source: Wisconsin Department of Revenue

retains a complex web of rules in which the type of service determines which tax applies on communications equipment used for similar purposes. In addition, these broad changes to business property taxation had left out telecommunications companies until recent legislative action.

This report uses data from the Wisconsin Department of Revenue to better understand the changing landscape of telephone taxation and consider questions about how telecommunications companies and their competitors should be taxed in the future.

FALLING REVENUES

The $50.1 million in telephone tax revenues in 2023 was the least since 1978 even without adjusting for inflation. This is a big decline from the 1990s, when tax collections peaked at between $100 and $180 million a year before adjusting for inflation. In some years in the 1990s, the tax generated more than 2% of total state tax revenue.

Telephone tax revenues dropped during the late 1990s and early 2000s, when the tax shifted from one based on the total revenue of the telephone companies to the current approach that taxes the property they own. Tax collections again fell as a result of a 2020 law that removed the tax from telephone company property used for providing broadband service to rural or underserved areas.

The recent changes are part of a much larger shift in which, over several generations, the state has repealed essentially all local taxes on personal property such as equipment, furniture, and tools while retaining property tax levies on land and buildings. Other types of utilities, like municipal electric companies, pipelines, and airlines however, are still subject to personal property tax.

Telephone tax revenue will continue to fall as a result of recently passed legislation that exempts personal property from state telephone taxes. That move will drop collections to approximately $5 million annually by 2028. Though this change reduces state revenue by $45 million or more per year, it also brings the treatment of telecommunications equipment for tax purposes in line with how local property taxes apply to personal property and does so at a time when the state surplus totals billions of dollars. Shifting how telecommunications companies' personal property is taxed shows that state leaders are treating telecom providers more like businesses in more competitive industries and less like utilities.

HOW IS UTILITY PROPERTY TAXED?

Telephone companies, electric and gas companies, railroads, and other utilities have traditionally been exempted from local property taxes and instead are taxed by the state. That's because their infrastructure – such as power plants and transmission lines, telephone wires, and cellular towers – is not evenly spread across the state, and their business revenue is not always generated locally. For example, electrical utilities are not subject to property taxes and instead have state taxes imposed on the total revenue from customer payments.

The revenues from all state utility taxes totaled $445 million in 2023, with approximately $400 million deposited into the state's general fund, and the remainder into the transportation fund. In 2023, the state general fund distributed $84.2 million in utility aids to local governments to compensate for property taxes on utilities that were not collected.

The telephone tax applies to landline and cellphone providers, as well as internet service providers, and was traditionally calculated based on the value of property, including both real estate and personal property, used for transmitting two-way messages.

When the tax was first created, telecommunications personal property largely meant copper wire carrying telephone and telegraph messages together with switches and other apparatus. Over the years, that was expanded to include other equipment used in two-way communications such as fiber-optic lines carrying internet data, and to transmit radio waves carrying cellphone calls, text messages, or internet connections.

The taxable value of most telecommunications assets historically has been determined based on their cost, but the taxable value of their real estate is based on its sales value. The tax rate is the same as the net property tax rate in each municipality where the assets are located.

The provisions of 2023 Act 140 will nearly eliminate state taxes on these telecommunications services by exempting tangible personal property from the telephone tax. That's because personal property is valued at $3.2 billion, making up more than 90% of the total taxable value of all telecommunications property.

The tax does still apply to the real estate associated with providing two-way communications, resulting in an estimated $5 million in revenue each year. Telecom providers are also still subject to corporate taxes, as well as a special telecommunications assessment. In addition, sales taxes apply to telephone and video services, but not to internet access, further complicating the system.

These changes bring taxes on telecommunication providers more in line with other competitive businesses, but the system still has some quirks.

DIFFERENT TAXES ON SIMILAR SERVICES

Wisconsin treats traditional cable television service differently from two-way services such as landline and mobile telephone and internet service. The type of service provided, internet or cable television, determines which tax applies, not the type of provider.

Cable television services have generally not been subject to utility or property taxes for many years, but are instead subject to local video service provider fees. This fee is based on the revenue generated by subscribers within a local jurisdiction such as a municipality or county. However, if a cable company also offers internet service, then the equipment and real estate used to offer two-way service could be subject to the telephone tax if the equipment is used the majority of the time to provide two-way service and not cable television service.

This difference made sense during the initial wave of cable television expansion, when telephone and cable services were quite different. Today, however, it's difficult for consumers to differentiate between cable companies and telephone companies, as they often offer package of services, including internet, video, and landline telephone. The video service fee does not apply to streaming services such as Netflix or Fubo that stream video through the internet.

SHIFTING MARKETPLACE

Utilities are treated differently for tax and regulation purposes as they often constitute a "natural monopoly." Electric companies are a good example, since it would be inefficient to have three competing companies build their own plant and network of power lines to serve a given community. For the first 100 years of telephone service, telephone companies functioned the same way.

However, the shift to cellular phones, the advent of cable, and the expansion of internet service have made telecommunications a more competitive market, particularly in urban areas. That has given policymakers an opportunity to consider some changes in regulation and taxes.

State leaders designed the current version of the telephone tax in the 1970s, when long-distance communication was vastly different. The recent legislation represents an attempt to adapt the laws of the state to the shift in the marketplace.

In another example, lawmakers and Gov. Tony Evers in recent years also reduced local fees on cable and telephone video service providers. These companies had been facing competition from telecommunications providers as well as streaming services.

CONCLUSION

In this world in which consumers can make phone calls through a traditional cable company, access the internet through a traditional telephone company, and video service from either – or neither – state and local officials face real challenges in setting up a fair, consistent, and up-to-date taxing regime.

For the benefit of both consumers and the various competing companies, elected officials have understandably been working to avoid or reduce differences in taxes and fees across different types of providers who now find themselves in essentially the same line of business.

Efforts to do so can reduce revenues for the state or local government, a potential concern since these funds could be used to increase broadband access or other worthy goals. They have also created a case where one traditional utility is now exempt from personal property taxes, while others continue to pay them.

On the other hand, reducing taxes on telecommunications infrastructure may offer some benefits by making the state a more appealing place for future investments by telecom providers and by acknowledging the more competitive marketplace that now exists.