Order Code RS20119
Updated February 1, 2001

CRS Report for Congress

Received through the CRS Web

The Telephone Excise Tax: Revenues, Effects, and Repeal Proposals

Louis Alan Talley
Specialist in Taxation
Government and Finance Division

Summary

The federal excise tax on local and long distance telephone service produces substantial revenues even at a tax rate of 3%. In the Budget for fiscal year 2001 it is reported that the tax reached a new record in collections of $5.185 billion in FY1999. These taxes go into the general receipts of the U.S. Treasury and are not dedicated to a trust fund or any other special purpose. In the debate over whether the tax should be repealed, interested parties have attributed a number of advantages and disadvantages to the tax. Not only is the tax administratively easy for the federal government to collect, but it also continues to generate large and stable amounts of revenue. Those who favor the tax note that there is no serious evidence that the communications industry has been injured by the past imposition of this tax. Among those opposed to the tax there is broad consensus that this is a regressive tax. They stress that telephone usage should be distinguished from the sumptuary ("sin") excise taxes imposed on items such as alcoholic beverages and tobacco. Opponents argue that the tax base is one which should be left to the states, that without this tax the communications industry would grow more rapidly, and that the economy would benefit from this expansion. In the 106th Congress, legislation passed which included the repeal of the telephone excise tax. That measure was vetoed by President Clinton. Thus, the tax continues at the 3% rate. This report will be updated if legislative actions occur in the current Congress.

Brief History[1]

The federal excise tax on telephone calls (also known as the communications tax) originated on long distance service under the *Spanish War Act of 1898*. This original tax applied when the call was valued at 15¢ or more. The tax was repealed in 1902 but reenacted as a tax on a per-message basis under the *Emergency Internal Revenue Tax Act*

[1] For a complete legislative history of the telephone excise tax see *The Federal Excise Tax on Telephone Service: A History*. CRS Report RL30553, by Louis Alan Talley.

of October 22, 1914 as America prepared to enter World War I. Subsequently, the tax was extended but was reimposed under the *War Revenue Act of October 3, 1917*. The tax was repealed in 1924. The federal tax on long distance calls has been levied on a continuous basis since passage of the *Revenue Bill of 1932*. That law was passed largely because of the federal budget deficit which occurred when income tax receipts declined because of the economic depression. The tax was extended to local telephone services a few months prior to the U.S. entrance into World War II by the *Revenue Act of 1941*.

In the 1960s, 1970s, and 1980s, the federal telephone excise tax was repeatedly imposed on a temporary basis. In general, the laws under which the tax operated called for a gradual phase-down in the tax rate before total repeal of the tax. Often, revenue problems surfaced before the repeal date and Congress responded by either increasing the rate in effect, or continuing the rate and stretching out the date to repeal of the tax.

Prior to passage of the *Revenue Reconciliation Act of 1990*, the tax was scheduled to expire on December 31, 1990. The 1990 Act permanently extended the tax at the 3% rate. The rationale for continuance was that budget deficits precluded allowing the tax to expire. Over the telephone tax's long history exemptions from the tax have been provide to governmental customers, the American Red Cross, non-profit educational organizations and non-profit hospitals, common carriers, radio and television broadcasting stations and others.

Revenues

The revenue from the telephone excise tax goes into the general receipts of the United States Treasury. It is used for general government expenditures as they accrue. It is not earmarked for any particular government function or service. The tax produces substantial and stable amounts of revenue. A table that provides annual telephone excise tax collections since fiscal year 1980 appears on the final page of this report.

Assessment

In the continuing debate over whether the federal excise tax on telephone service should be repealed, interested parties have attributed a number of advantages and disadvantages to the tax. Following is a brief discussion of some of the issues associated with proposed repeal of the tax: the incidence, revenue needs, federal-state revenue competition, communication industry effects, and administrative collection.

Incidence. Excise taxes are labeled as regressive taxes to the extent that low-income people spend a higher fraction of their income on the taxed item than high-income people. Opponents of the telephone excise tax find regressivity to be an objectionable feature not only of the telephone tax borne directly by consumers, but also of the telephone excise taxes paid by businesses, to the extent that tax burdens are shifted forward to consumers. A 1987 study by the Congressional Budget Office, *The Distributional Effects of an Increase in Selected Federal Excise Taxes*, concluded that among excises, those on alcoholic beverages and tobacco products would have less of an impact upon low-income families than those on telephone service.[2] It was noted that the telephone excise tax would

---

[2] U.S. Congressional Budget Office. *The Distributional Effects of an Increase in Selected* (continued...)

be assessed on nearly all low-income families (since 94% of households had telephone service in 1999), while taxes on alcoholic beverages and tobacco products were shown to affect only about a third of families with incomes less than $10,000 (since not everyone drinks alcoholic beverages or smokes).

Those who oppose repeal of the telephone excise tax argue that the entire federal tax structure, rather than its individual parts, should be examined and that the system as a whole is not regressive. Some note that the regressive telephone excise tax can be offset by progressive rates on federal personal income taxes. Additionally, proponents of the tax on telephone service argue that the tax on telephone service treats equally families who use the telephone equally.

As a result of the deregulation of the telephone system, costs for local telephone service have risen in many areas. In addition, there has been a proliferation of charges on telephone services.[3] Some have called for a revision of the federal excise tax as a means of helping lower-income persons retain their telephone service by subsidizing the telephone usage of the poor. That is, if this excise tax is to remain part of the tax structure, either low-income persons should be exempted from the tax or a trust fund be set up with revenues from the tax to help defray the cost of telephone service for the poor.[4]

Revenue Needs. Perhaps the principal argument used in recent years for continuation of the tax was the need for revenues in order to reduce federal budget deficits. Proponents argued that the federal tax on telephone service cannot be evaluated in a vacuum, but needs to be considered in the overall federal budgetary situation. In addition, proponents noted that a reduction in exemptions for either types of services (such as installation charges) or types of organizations exempted (nonprofit hospitals, educational organizations, federal and foreign governments, etc.) from the communications excise tax could easily generate large additional amounts of revenue.[5] While there are no longer annual federal budget deficits, some argue that tax cuts are not justified and that the surplus should be used to reduce the federal debt accumulated over many prior years of federal budget deficits.

Opponents of the tax concede that the elimination of the federal telephone tax would have an adverse effect on governmental receipts, but state that this objection does not begin to outweigh the many benefits that such a repeal would bring. Some opposed to the tax welcome the prospect of a modest tax cut; others state that the government could make up for this tax loss in many other ways – by tax reforms such as the elimination of

---

[2] (...continued)
Federal Excise Taxes. Staff working paper. [Washington] January 1987.

[3] These other charges are not covered by this report. For information on telephone charges see *Telephone Bills: Charges on Local Telephone Bills.* CRS Report RL30052, by James R. Riehl.

[4] As part of the federal universal service mandate, federal programs such as the Lifeline and Link-Up programs provide low-income consumers assistance to hook up to and remain on the telephone network.

[5] U.S. Department of theTreasury. Office of Tax Analysis. *Report to the Congress on Communication Services Not Subject to Federal Excise Tax.* August 1987. p. 28.

"loopholes" or by reducing wasteful and nonessential government expenditures, to mention just two alternatives.

Intergovernmental Relations. Some of those opposed to the federal telephone tax argue that this tax base could be left entirely to the states. Proponents of reserving this revenue opportunity for the states argue that this offers an excellent opportunity to reduce the trend toward centralization and bureaucracy in Washington and to "turn back" to the states revenue sources together with responsibilities for certain program areas.

Supporters of the federal tax say that there is no point in allowing this tax to be ceded to the states at a time when revenues are still needed to reduce the federal debt. If the federal excise tax is simply to be replaced by state levies, then this substitution negates the arguments advanced by proponents of repealing the tax. Supporters of the tax note that there is nothing preventing the states from levying the tax now and that many states already levy taxes on telephone service. Those that support retaining the federal tax point out that the arguments raised against the federal tax on such grounds as its regressiveness and its unjust burden on the telephone user would also apply to taxes at the state level.

Communications Industry Effects. Opponents of the tax argue that the elimination of the federal telephone tax would favorably affect the communications industry. While telephone companies do not bear this tax directly, through backward tax shifting they bear some of the economic burden of the tax. This burden is in the form of a reduction in both the number of subscribers and amount of services requested, caused by higher cost due to the federal excise tax. It has been additionally argued that placing an extra cost on telephone use discourages the expansion and improvement of telephone service. In the future, traditional telephone service may receive more competition from Internet telephony which is currently not subject to either the federal telephone excise tax or Federal Communications Commission (FCC) fees. Increased growth of the telephone industry, which elimination of the tax would presumably bring, should be considered in terms both of the many independent companies striving to make this industry more competitive and of the increased communication needs of this country.

Proponents of the federal telephone tax (particularly at its historically low 3% rate)[6] argue that they have not seen an adverse effect on the growth of the communications industry. Supporters of the tax also note that federal programs to assist low income consumers gain access to and remain on the telephone network are in part supported indirectly (since telephone taxes go into the general fund) from the revenues this tax generates.

Administration. Those in favor of the tax note that the federal excise tax on telephone service has administrative advantages. Because the telephone companies collect the tax from the customers, the federal government is spared this expense. The administration of the tax by the federal government is therefore much simplified. In addition, it is difficult for the telephone user to evade payment of this tax. Those persons refusing to pay this tax are easily identified and action can be taken against them.

---

[6] The tax rate has been as high as 25%.

Opponents of the tax note that it is not the function of the telephone company to act as the collection agent for largely "invisible" federal taxes. Further, administrative costs associated with collection are most likely passed forward and are borne by consumers through higher charges for service.

Legislation in the 106th Congress

In the 106th Congress, a number of bills were introduced calling for the repeal of the federal telephone tax. The Ways and Means Committee unanimously passed on May 17, 2000, an amended bill (H.R. 3916) that Representatives Rob Portman and Bob Matsui (members of the Ways and Means Committee) introduced to repeal the telephone tax. That bill was passed by the House of Representatives on a 420 to 2 vote. The House passed bill proposed to reduce the tax to 2% beginning 30 days after enactment through September 30, 2001. The tax would then be reduced to a 1% rate until its expiration on September 30, 2002. The Joint Committee on Taxation had estimated the bill would cost $19.9 billion over a 5-year period. Treasury Secretary Lawrence Summers wrote Chairman Archer stating that "the Administration believes that the phasing out ... is a worthy policy objective" and that the tax "is economically inefficient and reduces progressivity." It was initially reported that President Clinton would sign the legislation if enacted as part of an "appropriate, overall budget framework."

Senator Roth, Chairman of the Finance Committee, offered substitute language to the House passed bill which provided for total repeal of the communications excise tax for bills rendered after August 31, 2000. In addition, Senator Kerrey filed an amendment that was included. That amendment required the General Accounting Office (in consultation with the Federal Communications Commission) to provide a report to the committees of jurisdiction that details the amount of repealed communications taxes passed on to residential and business consumers. The Joint Committee on Taxation estimated the version as passed by the Finance Committee would lose revenues of $24 billion over the six fiscal years 2000 - 2005.

The telecommunications excise tax repeal was incorporated into an appropriations measure (H.R. 4516). Under this legislation, the excise tax would have been repealed for bills rendered after September 30, 2000. This legislation also required a study called for under the Senate Finance Committee's version of the legislation. After passage of this legislation by Congress, it was vetoed by President Clinton.

Table 1. Telephone Excise Tax Collections

Fiscal Year	Rate of Tax (percent)	Collections from Telephone and Teletype Service ($ thousands)
1980	2%	$1,117,834
1981	2	998,503
1982	1	919,749
1983	3	1,048,317
1984	3	2,034,965
1985	3	2,307,607
1986	3	2,339,153
1987	3	2,522,062
1988	3	2,555,082
1989	3	2,266,000
1990	3	3,075,209
1991	3	2,952,522
1992	3	3,173,000
1993	3	3,351,600
1994	3	3,774,000
1995	3	3,825,700
1996	3	4,243,400
1997	3	4,706,800
1998	3	4,747,227
1999	3	5,185,000

Note: During the 1960s and 1970s, the tax rate was as high as 10 percent.

Sources: For fiscal years 1980 to 1989, collection figures have been taken from appropriate *Annual Reports of the Commissioner of Internal Revenue* published by the Department of the Treasury, Internal Revenue Service, Publication 55.

For fiscal years 1990 and 1991, collection figures have been taken from appropriate information releases entitled *Internal Revenue Report of Excise Taxes*.

For fiscal years 1992 to 1998, collection figures have been taken from the *Statistics of Income Bulletin*, issued in Winter 1999-2000 (Vol. 19, No. 3) published by the Internal Revenue Service.

For fiscal year 1999 the collection figure came from the U.S. Office of Management and Budget. *Budget of the United States Government, FY2000,* Analytical Perspectives. February 2000. p. 91.