BRIEFING

Legislature Should Reduce Florida's High Communications Services Tax

The Issue

The highest combined state and local sales tax rate in Florida is 7.5%. However, when Floridians purchase taxable communications services, such as cell phone service, they pay an average tax rate of more than 14%--and that rate can exceed 16%. Florida has one of the highest tax rates on communications services in the nation and that rate is much higher than the sales tax rate on other retail purchases in Florida.

Taxes vary considerably across the state and some communications services are taxed at different rates, but when a Florida consumer purchases communications services, it is usually taxed at twice the rate of the sales and use tax rate. It is difficult to do a true "apples to apples" comparison of tax rates on communications services, but it is clear that Florida's tax rate is one of the highest in the nation.

These facts raise questions about the fairness of the tax rate, its economic neutrality, its effect on the competitiveness of Florida businesses and the attractiveness of Florida's economic climate.

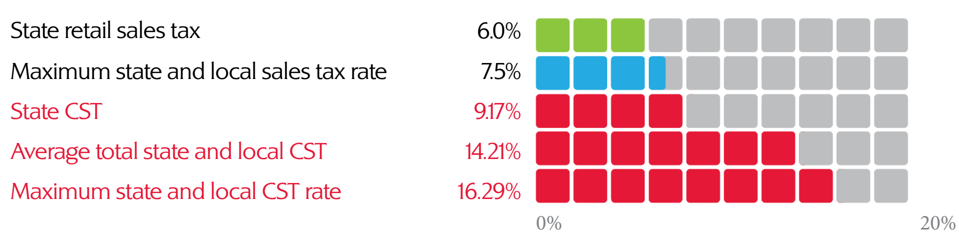
Background

The CST was created in 2001 in an effort to simplify state and local taxation of communications services. The new CST replaced a myriad of revenue sources: state and local sales taxes, the gross receipt tax, local utility taxes, franchise fees, and permit fees. The new tax is centrally administered by the Florida Department of Revenue and rates were set to make it revenue neutral for state and local governments.

Tax Base

The CST is levied on the sales of communications services including telephone (landline, mobile and voice over internet), cable television and other video service, and direct-to-home satellite television. Residential landline phone service is partially exempt, residential cable and satellite services are not exempt. All mobile phone service — both residential and commercial--is taxable. Pre-paid calling services — if only limited to telephone service — is not subject to the CST, but is subject to the sales tax. Internet access is exempt from taxation by federal law.

Comparison of Tax on Communications Services to Most Other Purchases



Tax Rates

There is a state and a local component to the CST. The state CST consists of two parts: a 6.65 percent state CST rate and a 2.52 percent gross receipts tax–for a total state rate of 9.17 percent. Direct-to-home-satellite services are taxed at a statewide rate of 13.17 percent; the local option component does not apply to these services due to federal law.

The local CST is a local option tax. Each jurisdiction (municipalities, charter counties and non-charter counties) have their own rate. Counties may only levy the tax on their unincorporated areas. Municipalities and charter counties may levy up to a rate of 5.22 percent and non-charter counties may levy up to a rate of 1.84 percent. There are currently 481 separate taxing jurisdictions and 122 different rates, ranging from 0 percent to 7.2 percent. The weighted average[1] local CST rate in Florida is 5.04 percent. The majority of local jurisdictions (65 percent) have rates between 5 percent and 6 percent.

Revenues

The CST will raise an estimated $2.2 billion in FY 2012-13, with approximately $750 million of that total coming from the local option component. The state also shares a portion of the state CST with local governments. For distribution purposes, the main state CST ($1 billion) is treated like the sales tax, meaning that close to 90 percent goes to state general revenue. The $409 million collected from the gross receipts portion goes to fund school construction projects. Revenue collections from the CST are decreasing, having fallen 14 percent since 2005.[2] Reasons for this decline are discussed later in this report.

1 Weighted average= statewide revenues/taxable sales
2 Office of Economic and Demographic Research, results of Revenue Estimating Conference for Gross Receipts Tax/Communications Services Tax, November 27, 2012

Florida Taxes Communications Services Higher than Almost Every State

A survey[3] by the Florida Department of Revenue (DOR) confirmed that Florida's CST is high when compared to other states. Highlights of the survey include:

- Only one state (California) has a higher total state and local tax than Florida;
- No state has a higher state tax rate[4];
- Only two states (New York and Maryland) have a higher local tax rate;
- Most states tax communication services at the same rate as the general sales tax;
- Florida has the highest variance in tax among taxable services (2.37% to 16.29%); and
- Florida (0% to 7.12%) has the second highest variance in local rates among jurisdictions after Maryland (0% to 8%).

As mentioned earlier, a true "apples to apples" comparison of state taxation of communications services would be very difficult. State to state differences in definitions and the types of services taxed complicate the issue. Another issue is the fact that Florida's CST was a replacement of multiple taxes, including franchise and permit fees. Before the CST, Florida local governments charged providers franchise fees for their use of public rights-of-way and permit fees for construction in rights-of-way.

The revenue collected by these fees was included in the revenue-neutral rates set by the CST law. As a result, local governments can no longer charge franchise fees to communications services provides and the use of permit fees is restricted. Therefore, comparison of Florida's CST rate to

3 Presented to the Communications Service Tax Working Group, June 11, 2012
4 The District of Columbia's rate of 10 percent to 11 percent is higher than Florida's state rate

states that charge a franchise fee that is not reflected in their CST could result in understating the other state's tax rate on services that may be subject to franchise fees (particularly landline telephone and cable.) However, it should be noted that a number of states responding to the DOR survey reported that they do not apply a CST to cable service. In addition, services for which franchise fees typically do not apply, such as wireless, are now effectively paying those taxes in Florida since they were rolled into the CST.

A 2010 study[5] compared taxes paid on wireless communication among the 50 states. Comparing wireless taxes, while not the whole CST story, allows for more of an "apples to apples" comparison. The number of wireless users is increasing rapidly, growing to the point where there is almost one wireless phone for each man, woman and child in Florida. In 2010, there were an estimated 16.9 million wireless phones in Florida, 35 percent more than in 2005. Conversely, there were 6.4 million land line phones in 2010, down from 11.5 million five years before.[6]

Wireless Tax Rates Across the U.S.

	State	Rate		State	Rate
1	Nebraska	18.64%	27	Minnesota	9.38%
2	Washington	17.95%	28	Mississippi	9.08%
3	New York	17.78%	29	New Jersey	8.87%
4	**Florida**	**16.57%**	30	Georgia	8.57%
5	Illinois	15.85%	31	Vermont	8.50%
6	Rhode Island	14.62%	32	Wisconsin	8.34%
7	Missouri	14.23%	33	New Hampshire	8.18%
8	Pennsylvania	14.08%	34	Ohio	7.95%
9	Kansas	13.34%	35	Wyoming	7.94%
10	Texas	12.43%	36	Iowa	7.91%
11	Maryland	12.23%	37	Massachusetts	7.81%
12	Utah	12.16%	38	Hawaii	7.75%
13	South Dakota	12.02%	39	Alabama	7.45%
14	Arizona	11.97%	40	Michigan	7.27%
15	DC	11.58%	41	Maine	7.16%
16	Tennessee	11.58%	42	Connecticut	6.96%
17	Arkansas	11.07%	43	Alaska	6.69%
18	Oklahoma	10.74%	44	Virginia	6.56%
19	North Dakota	10.68%	45	Louisiana	6.28%
20	California	10.67%	46	Delaware	6.25%
21	New Mexico	10.52%	47	West Virginia	6.23%
22	Kentucky	10.42%	48	Montana	6.03%
23	Colorado	10.40%	49	Idaho	2.20%
24	Indiana	9.84%	50	Nevada	2.08%
25	South Carolina	9.52%	51	Oregon	1.81%
26	North Carolina	9.43%			
				US Simple Average	**9.87%**
				US Weighted Average	**11.21%**

The study found that Florida has the fourth highest tax on wireless services- 16.57 percent—trailing only Nebraska, Washington and New York (see table at right).

The rate used for each state was based on the average between the state's capitol and largest city. For Florida, this was Tallahassee (local rate of 6.9 percent) and Jacksonville (5.82 percent). The study also included state and local 911 fees, which are not part of the CST. The report also found that Florida has the third highest variance between its wireless tax and its state and local sales tax.

Further heightening the discriminatory nature of the tax rate nationwide, the report also points out that federal taxes of just over 5 percent apply to wireless service.

5 Scott Mackey, "A Growing Burden: Taxes and Fees on Wireless Service," State Tax Notes, February 14, 2011.
6 Florida Public Service Commission

What Are the Effects of High CST Taxes in Florida?

It is clear from the available data that CST taxes in Florida are among the very highest in the nation. Fairness is certainly called into question when consumers are asked to pay a tax rate that often exceeds double the general sales tax rate, particularly for services most people would consider a necessity. The variation in tax rates between services and geographic locations also raise questions of equality.

The high rate of Florida's CST also increases the regressivity of the tax. This is especially true for wireless service. Low income populations rely heavily on wireless for voice service and internet access. Since these families spend a higher portion of their disposable income on wireless service, high taxes are regressive and punitive. The partial exemption for residential landlines help the overall regressivity of the CST somewhat; however, state and local taxes on residential landlines can still exceed 9 percent.

The Communications Services Tax Working Group was created by the 2011 Legislature to examine the CST and recommend options for change. The Working Group's recently released final report states:

> "For a tax system to work well, it should be reliable, simple, neutral, transparent, fair, and modern. Florida's Communications Services Tax could benefit from reform in nearly every one of these areas, especially given the pace of technological change over the last 11 years. Under the status quo, state and local governments will likely experience revenue declines as discriminatory tax policy, technological changes, and consumer preferences continue to undermine the Communications Services Tax base by shifting consumer purchases to services not subject to the tax."[7]

This effect is increased the higher the tax rate goes. When a tax can be as high as 16.29 percent, alternative products which may not be subject to the tax become even more desirable. Taxes should be neutral to the extent possible, meaning taxes should not cause individuals or firms to alter their economic choices, such as choosing products.

People are switching from wireless plans to prepaid calling arrangements, a switch made more attractive by the general sales tax being applied to prepaid calling. Internet video products and services, which may not be taxed at all, put cable providers at a competitive advantage. The pace of technological change makes it likely that more tax-free options will be coming in the near future.

High taxes on wireless and other communication services can impede the growth of wireless infrastructure and broadband networks which can in turn impede economic development and job growth.

Moreover, when Florida businesses have to pay higher taxes than virtually any other state on the communications services they consume, they are put at a competitive disadvantage with other states and the attractiveness of Florida as a place to do business is compromised.

7 Final report of the Communications Services Tax Working Group, February 1, 2013.

Conclusion and Recommendation

There are numerous problems associated with the Communications Services Tax, and the high tax rate is one of them. The Communications Services Tax Working Group found that the technological changes since the tax was enacted in 2001 have created competitive and neutrality questions, difficulties in administering, complying with and enforcing the tax, questions about taxability and an eroding revenue stream. The Working Group has recommended eliminating the CST and applying the sales tax to communications services. In order to be revenue neutral to all jurisdictions, the general sales tax rate would have to be increased from 6 percent to 6.34 percent.

While this would certainly address many of the problems with the tax, it is a major tax change that needs more study. And if the initial legislative response to the recommendation is any indication, it is probably not politically feasible at this time.

Instead, in addition to considering some of the other more limited recommendations of the Working Group, the legislature should look to reduce CST rates. This can be done while still protecting local government revenue and funding for education facilities by using sales and use taxes collected from remote sales. Florida TaxWatch has been a long-time promoter of taking steps to collect the tax that is currently owed on internet and remote sales but is often not collected (see Report and Recommendations of the Florida TaxWatch Government Cost Savings Task Force for FY 2013-14). After years of inaction, it appears this may be the year for the legislature to act.[8] The Governor and some legislative leaders have indicated they would be open to legislation to collect these taxes, as long as other taxes were cut to make it revenue neutral.

Lawmakers would be hard pressed to find a more justifiable way to provide broad-based state tax relief than a reduction in the CST. There is no discernible public policy justification for what amounts to discriminatory taxes on Floridians' communications services. The average total tax rate paid on these services is more than double the state and local sales tax rate that applies to most other retail purposes. The high tax rate relative to other states also raises economic development and competitiveness concerns.

It must be remembered that the CST is a tax on consumers, not communications services providers. Reducing the regressive CST would benefit a wide range of Floridians, affecting virtually all individuals and businesses.

8 On February 5, 2013, the Senate Committee on Commerce a Tourism approved a Committee Substitute for Senate Bill 316, a remote sales tax collection bill, adding a provision that additional revenues collected under the bill go to reduce the CST and provide an expanded sales tax exemption for manufacturing machinery and equipment.

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