Estimating Mobile Telecommunications Sales Tax Revenue in New York State

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prepared for
FTA 2002 Revenue Estimating/Research Conference
Tempe, Arizona
September 2002

I. Introduction and Overview

New York imposes State and local sales tax on mobile telecommunications. The characteristics of mobile service introduced complexity and uncertainty into tax compliance. To simplify and unify taxes on mobile telecommunications, the industry sponsored federal legislation, the *Mobile Telecommunications Sourcing Act* (MTSA) which passed in 2000 and took effect August 2002.

Overall, the MTSA was designed to be revenue neutral. However, it had the potential for revenue consequences in individual states and localities. Evaluating the potential revenue consequences first required knowing how much sales tax the industry generated, how the tax was distributed locally, and how these two factors changed over time. Given the dynamic nature of the wireless industry, developing this information required creative approaches to collecting and evaluating sales tax data. For example, mapping collections by county and regional service area uncovered data problems such as missing tax returns in a particular sales tax quarter. Once a problem was identified, audit staff, the Department's accounting bureau, other government agencies, and individual companies contributed to finding solutions.

Our results proved that the extra effort was worthwhile. In the 12-month period from June 1999 through May 2000, mobile telecommunications providers reported an estimated $3 billion in taxable sales and collected an estimated $230 million in State and local sales tax. This estimate compared favorably with nontax sources and provided a foundation for analyzing legislation to implement the sourcing act.

II. New York's Sales Tax on Mobile Telecommunications Services

New York imposes State and local sales tax on mobile telecommunications as part of its sales tax on 'telephone service . . . of whatever nature.' A charge for interstate or international service is exempt.[1] Like other telephone service, mobile telecommunications is subject to State, county, city, and school district sales taxes.

- New York's State sales tax rate is 4%.
- Local rates (county or city) range from 2.75% to 4.25%.
- An additional 0.25% rate applies in the twelve-county Metropolitan Commuter Transportation District.
- School districts that are coterminous with, or wholly or partly located within, a city of less than 125,000 may impose an additional sales tax on utility services – including telephone services – of up to 3%.

The different State and local sales taxes result in more than 100 different taxing jurisdictions and combined sales tax rates ranging from 6.75% to 11.5%.

III. The Mobile Telecommunications Sourcing Act

[1] New York State Tax Law, Article 28, Section 1105(b).

The characteristics of mobile telecommunications service introduced complexity and uncertainty into tax compliance. Unlike most telephone service, mobile services does not originate in a single location. In the past, the methods used to collect sales tax varied from company to company. Three known practices were to use the customer's billing address, the location of the company's equipment handling calls (e.g., a mobile telecommunications tower or telecommunications switching equipment), or the customer's telephone number.

Taxpayers and local governments had raised concerns that the different practices used to collect sales tax were inequitable both for the taxpayer and local revenue distribution. As a result, the Department studied the issue in its January 1997 report *Improving New York State Telecommunications Taxes: Final Report and Recommendations*. The Department recommended using a single tax situs standard of the subscriber's location of primary use. The location of primary use would generally correspond with a customer's billing address. The mobile telecommunications industry supported this methodology but asked for a delay in the implementation to formulate a nationwide approach.

To simplify and unify the sales taxes on mobile telecommunications services nationally, the industry sponsored federal legislation, the *Mobile Telecommunications Sourcing Act* (MTSA). This legislation passed in 2000 and took effect August 2002. Under the MTSA, the taxing jurisdiction of the customer's *place of primary use* is the only jurisdiction with authority to tax service provided to that customer. The place of primary use is represented by a customer's residential or business street address within the home service provider's licensed service area. All calls, regardless of where they actually occur, are deemed to occur at the place of primary use.[2] An example of how this differed from prior reporting practices is illustrated below.

State and Local Sales Taxes on Mobile Telecommunications Services	
Before MTSA	*After MTSA*
Determined using the customer's billing address, the location of the company's equipment handling the calls, or the customer's telephone number.	Determined using the customer's place of primary use (e.g., home address.)

[2]For a description of New York's legislation which responded to the Mobile Telecommunications Sourcing Act, see TSB-M-02(6)S, *Amendments Affecting the Application of the Sales and Use Tax and Excise Tax Imposed on Mobile Telecommunications Service*.

Overall, the MTSA was designed to be revenue neutral. However, it had the potential for revenue consequences in individual states and localities. For New York, the MTSA potentially affects State and local sales tax revenues in four major areas:

- *Local Revenue Distribution* - Taxing mobile service at the place of primary use redistributes some local sales tax revenue.

- *Roaming* - The MTSA preempts state authority to impose sales tax on nonresidents, but lets states tax calls residents make while outside the state.

- *Customers Near Bordering States* - Taxing mobile service at the place of primary use redistributes some revenue between New York and bordering states.

- *Flat Rate Plans & Bundled Services* - The MTSA provides a method for home service providers to separately account for nontaxable mobile telecommunications charges included in a 'bundle' or 'bucket.'

IV. Estimating Mobile Telecommunications Sales Tax Revenue

Following enactment of the federal Act, the Office of Tax Policy Analysis (OTPA) began researching the MTSA's potential revenue consequences. In particular, we wanted to know:

- How much sales tax was remitted on mobile telecommunications services?
- How were collections distributed among the local taxing jurisdictions?
- What trends were evident from the data?

To answer these questions, we first compiled the reported taxable sales of about 80 vendors identified as mobile telecommunications service providers in the 1997 report. By matching sales tax identification numbers against our annual sales tax Master File extract files, we obtained State and local sales tax information for all quarterly tax periods beginning with June 1995 and ending May 2000. We tabulated the resulting information by tax period and taxing jurisdiction and combined it with similar information compiled in 1996.

The preliminary findings were disappointing. They showed declining revenue and a concentration of mobile service in urban areas. This was just the opposite of the trends reported by industry and reflected in our excise taxes and began a two-year process of identifying missing firms and various reporting errors and remedying the problems.

One tool used to identify data problems was to illustrate year-to-year changes in reported taxable sales by locality and the FCC designated service area. Displaying this information graphically clearly showed regions where we were missing firms or experiencing other data problems. Moreover, since only a handful of companies operates in any given region, a regional analysis helped us account for changes in company ownership and filing patterns.

Apparent vendor reporting inconsistencies were researched with our accounting, processing, and audit units. In some cases, staff was already aware of reporting issues (e.g., a one-time deviation in local sales tax reporting) and had contacted the company for correct information. In other cases, we had to wait for these issues to be administratively rectified and posted to the Master file.

An Iterative Process

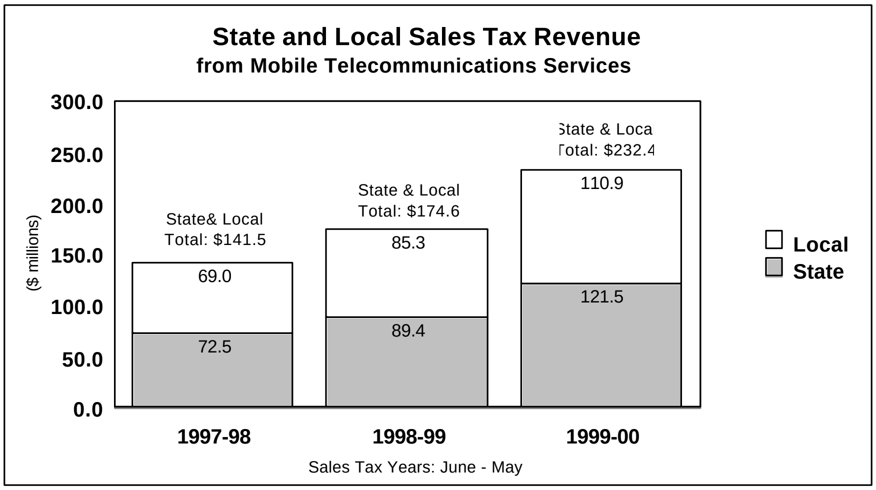
- ✓ Compiling Sales Tax Master File data
- ✓ Constructing regional tabulations
- ✓ Examining regional growth trends
- ✓ Identifying regions with unusual growth patterns
- ✓ Identifying if the unusual pattern was the result of:
  - misreported revenues
  - missing a company
  - including the wrong company
- ✓ Fixing problems

The most vexing challenge of this project was to locate in our sales tax Master File the tax records of the businesses we had failed to identify initially. Identifying the missing businesses was a process of researching corporate changes and looking for new entrants doing business in New York State. We used numerous public and private data sources including, New York State Public Service Commission information, information from other New York taxes, audit information, company contacts, Federal Communications Commission records (e.g., license data), Hoovers, Moody's and other similar business reports, company Web sites, the Sales Tax Master File itself (using a search for related industry terms), and even the Yellow Pages. Once companies were identified, we searched our sales tax Master File using a custom SAS program constructed in-house for selecting the firms' tax records.

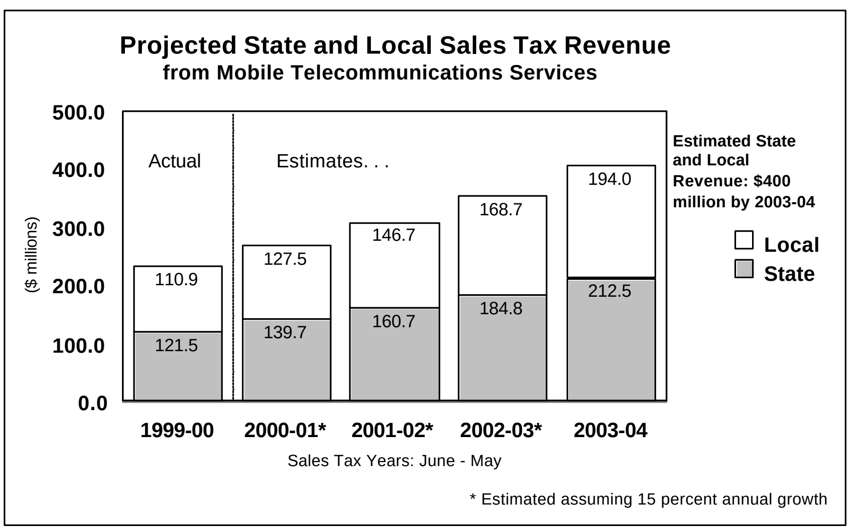
Some of the obstacles to identifying the missing businesses included that businesses were not registered with the Department by trade name or the name of the parent corporation, had gone through multiple mergers, acquisitions or breakups, could not easily be identified using SIC and NAICS codes, or, had multiple tax registrations (sometimes for each CGSA or cell site). Furthermore, names on the sales tax Master File record sometimes contained abbreviations, unusual character positioning (e.g., ABC Inc. became A. B. CINC.), or were incorrectly keyed. In the end, we identified nearly 300 vendors as having provided mobile telecommunications services within the five-year period.

V. Findings

Our findings indicated that in the 12-month period from June 1999 through May 2000, mobile telecommunications service providers reported $3 billion in taxable sales. This equates to computed State and local sales tax of $230 million, approximately $120 million in State tax and an estimated $110 million in local tax.



We also found that the reported taxable sales of mobile telecommunications experienced significant annual growth. In years ended May 1999 and May 2000, the annual growth was 23% and 33% respectively. These results were consistent with collection trends in New York's Telecommunications Excise Tax and with national trends.[3]



[3]Nationally, in recent years the annual growth in mobile telecommunications revenues ranged from 16% to 25%. (See U.S. Census Bureau's *Statistical Abstract of the United States* and the Cellular Telecommunications and Internet Association's *Semi-Annual Wireless Industry Survey*.)

Industry analysts expected annual subscription revenue to level off but to remain at 15% through 2005.[4] Given that level of growth, State and local sales tax revenue from mobile services could reach $350 million during SFY 2002-03 and $400 million in SFY 2003-04.

VI. Conclusion

The above estimates were based solely on the sales tax returns of a select group of vendors. While this research accurately reflected the information reported on the tax returns of those vendors, we were cognizant that it had been developed in isolation from other industry and government information. Consequently, we were curious to see how our results compared with other data sources.

For purposes of comparison, we reviewed a report issued by the Federal Communications Commission in April 2001 titled *State-by-State Telephone Revenues and Universal Service Data*.[5] As its title indicates, this report presents state-by-state estimates of telephone service revenue. The state estimates are presented by type of carrier (LEC, CLEC, mobile wireless, etc.), type of revenue (end-user, carrier revenue, total revenue) and, type of service (intrastate and interstate).

According to this report, New York intrastate end-user revenues of mobile wireless carriers were $2,372 million in 1999.[6] Converting sales tax return data into near-calendar year 1999 (December 1998 - November 1999), the estimated 1999 taxable sales of wireless service providers were $2,473. This compared favorably with the federal estimate considering the differences in what is being measured and provided a foundation for analyzing legislation to implement the sourcing act.

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[4]"Wireless Sobers Up", *America's Network*, November 15, 1999, pg. 21. However, some recent reports suggest a slower growth due to declining prices and a slowdown in new subscribers.

[5]The full citation for this report is: Cavazos, Robert and James Eisner, *State-by-State Telephone Revenues and Universal Service Data*, Federal Communications Commission Common Carrier Bureau, April 2001. It is available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/strev-99.pdf

[6] *State-by-State Telephone Revenues and Universal Service Data*, Table 3.