



November 18, 2014

Dear Chairman Wheeler and Commissioners:

On behalf of the American Consumer Institute Center for Citizen Research (ACI), I am writing to urge you to place the interests of broadband consumers ahead of those calling for reclassification of broadband services as a telecommunications service under Title II regulation.¹ ACI is a 501c3 nonprofit educational and research institute founded on the belief that consumer interests are not satisfactorily represented in a wide variety of public policy proceedings or in government decisions in which their welfare is substantially at stake. As I will demonstrate, it is undeniable that reclassifying broadband services under Title II regulations would lead to a decline in consumer welfare – so much so that any benefits derived from net neutrality regulations will pale in comparison with its costs.

The FCC is considering the reclassification of broadband services, in whole or in part, from an “information service” to a “telecommunications service” to give it more regulatory authority over Internet Services Providers (ISPs). Reclassification of broadband services would effectively redefine broadband as a regulated telecommunications service, which could subject the broadband industry and its services to existing state and local taxes intended solely for regulated telecommunications providers and public utilities.

Under existing state and local tax laws, the increased tax exposure from reclassifying broadband services could come in several forms. Utility property is generally taxed at a higher rate or under a broader base than other commercial property. Since reclassification would put broadband access under Title II regulation of the Communications Act, many states are likely to use this new regulatory designation to generate additional property tax revenues by taxing broadband property at the higher rates or under the broader base that currently applies to telecommunications property. Some states would likely use the reclassification by the FCC to designate a service provider as *regulated* in order to tax broadband property as they would tax any public utility without having to pursue the more challenging course of securing a legislative change.²

¹ In the Matter of Preserving the Open Internet (GN Docket No. 09-191) and Protecting and Promoting the Open Internet (GN Docket No. 14-28).

² For example, North Carolina G.S. 105-333 defines a public service company as including companies regulated by the FCC.

Besides the higher tax rates that may be imposed on regulated telecommunications plant and equipment, the assessment methodologies used in some of these jurisdictions includes the value of intangible property. For cable, wireless and other ISP platforms, the inclusion of intangible property in the property tax base could become quite substantial. For instance, wireless providers are completely dependent on spectrum that was purchased during FCC competitive auctions. In states that consider intangible property to be taxable property, if reclassification occurs, the taxation of broader telecommunications property could represent a major increase in the property taxes assessed to broadband providers.

Another major risk is that state and local governments will not discern what portion of plant is solely used for Internet connectivity. They might simply designate all of the firm's property as "mixed use" and subject it to the full taxation as telecommunications property. Therefore, ISPs that provide video services, information services and other lines of business could have the tangible and intangible property for these other lines of business taxed at higher rates and under a broader base for property tax purposes, exposing the entire business to these higher costs. The result would be a significant increase in property taxes affecting wireless telecommunications, cable and other ISP providers immediately after reclassification occurs.

If reclassification defines broadband service as a telecommunications service, for similar reasons noted above, state and local receipts-based taxes imposed upon utility-like services could become a significant cost for all ISPs. Most receipts based-utility taxes were enacted in the mid-20th century and are imposed upon the gross receipts from the sales of specified services. These taxes are typically recovered by providers as part of the monthly billing process, resulting in higher prices for consumers.

Depending on the state, these telecommunications and utility taxes may apply specifically to telecommunications services, regulated services or public utility services in general.³ Essentially, wireline and wireless broadband service providers (or at least the Internet connectivity portion that makes up the vast majority of broadband services) could be exposed to state and local taxes on certain broadband revenues. For ISPs, recouping these taxes will mean passing these costs along to consumers in the form of higher broadband prices, including bundled services.

There may be other tax increases resulting from reclassification. For instance, some state and local jurisdictions may see new regulated revenues as being subject to other telecommunication specific taxes and fees. Also, according to one study, a tax on

³ For example, Maryland statute Section 8-401 imposes a 2% gross receipts tax on telecommunications service providers, including competitive local exchange companies. Mississippi Title 21, chapter 33-203 imposes a city utility tax of 2% on the gross revenue collected by all telecommunications and communications utilities.

broadband services to support the Universal Service Fund (USF) could increase the price of broadband services by 15% or more.⁴

It is worth noting that the current extension of the Internet Tax Moratorium precludes state and local taxation of Internet access, including the underlying telecommunications service purchased, used or sold to provide Internet access. Accordingly, state and local governments are not, except for grandfathered cases, permitted to tax the transmission portion of Internet access. However, upon expiration of the moratorium on December 11th of this year, reclassification of the Internet connectivity portion of Internet services to a telecommunications service could subject these revenues to tax at the average rate of 17% presently imposed upon other telecommunication services.⁵ The combination of these taxes, along with taxes that would be permitted after reclassification (described earlier in this letter), will be significant, as I noted in my July 2014 article in Forbes.⁶

Since broadband services are relatively price elastic, meaning that consumers are very sensitive to changes in the price for these services, the impact of these tax increases will be significant, particularly to lower income and marginally connected consumers.⁷ Increasing taxes on a good or service that is price elastic would result in a drop in quantity demanded that is greater than the increase in price. Such an outcome would lead to a decline in total industry revenue.⁸ Even if broadband services are unitarily price elastic, a 17% increase in price will lead to a corresponding decrease in demand. The resulting demand suppression would more than outweigh any benefit that more openness or neutrality could ever bring.

⁴ According to the president of the Phoenix Center for Advanced Legal & Economic Studies, see Lawrence Spiwak, "The FCC's Disingenuous "Third Way" on Broadband," CNET, May 19, 2010. Currently, the USF is a redistributive fund, taxing telecommunications services while providing support to some telephone companies and consumers.

⁵ For example see David Tuerck, Paul Bachman, Steven Titch and John Rutledge, "Taxes and Fees on Communications Services," The Heartland Institute, #113, May 2007, p. 1. A number of studies show similar results and these studies will be cited later in this paper.

⁶ Steve Pociask, "A Perfect Storm: Net Neutrality and the End of the Internet Tax Moratorium," Forbes, July 7, 2014, <http://www.forbes.com/sites/realspin/2014/07/07/a-perfect-storm-net-neutrality-and-the-end-of-the-internet-tax-moratorium/>.

⁷ For a review of the literature on broadband elasticity, see J. Gregory Sidak, "A Consumer Welfare Approach to Network Neutrality Regulations of the Internet," forthcoming in the *Journal of Competition Law & Economics*, Oxford Press, Vol. 2:3, September 2006; Austin Goolsbee, "The Value of Broadband and the Deadweight Loss of 2006; Shane Greenstein and Ryan C. McDevitt, "The Broadband Bonus: Estimating Broadband Internet's Economic Value," Kellogg School of Management, Northwestern, working paper, April 2010; and Mark Dutz, Jonathan Orszag and Robert Willig, "The Substantial Consumer Benefits of Broadband Connectivity for U.S. Households, Compass Lexecon, July 2009.

⁸ For an illustration of this tax effect see Neil M. Singer, *Public Microeconomics*, Little, Brown and Co., Boston, MA, Second Edition, 1976, p. 243.

Interestingly, in suggesting a need to reclassify broadband services, the FCC has cited 6% Americans without “broadband access” as evidence that deployment is not happening in a timely manner.⁹ If we consider the potential impact of taxation on consumer welfare, the analysis would show that the potential increase in taxes and broadband prices would reduce the number of broadband subscribers by more than the FCC hopes to connect. In other words, the suppression of demand from the potential increase in state and local taxes would actually exceed number of consumers without broadband access. Reclassification would cause more harm to consumers than good.

The effects on the economy would also be significant. As stated, reclassifying broadband services from an information service to a telecommunications service would result in Internet Service Providers paying higher state and local taxes, which in turn will raise consumer prices. In turn, higher consumer prices would reduce both subscribership and consumer welfare. For the broader economy, demand suppression would reduce economic output, jobs and employment earnings. For example, higher property taxes would directly discourage network investment. Ironically, lower levels of investment, higher prices and reduced demand are precisely the opposite outcomes that Congress and the FCC have set out to achieve in the National Broadband Plan.

While a precise quantification of this impact is certainly possible and I would be willing to help the FCC undertake such a measurement, one important public policy consideration comes to the forefront -- if the goal of Congress and the FCC is to improve broadband affordability, adoption and access, as well as increase consumer welfare, reclassifying broadband services does the exact opposite. In other words, if the FCC reclassifies broadband services, Congress and the FCC will have woefully failed to meet its goals for a nationwide broadband plan.

In light of these facts and in the interests of broadband consumers, I urge the FCC to reject proposals to reclassify Internet services, in part or in whole, under Title II regulations.

Respectfully submitted,

Steve Pociask
President / CEO
American Consumer Institute
Center for Citizen Research
1701 Pennsylvania Ave, NW, Suite 300
Washington, DC 20006

⁹ “Eighth Broadband Deployment Report,” FCC, released August 21, 2012, report and statements available at <http://www.fcc.gov/reports/eighth-broadband-progress-report>.