

## RETAIL TELECOMMUNICATIONS EXCISE TAX

### Revenue Description

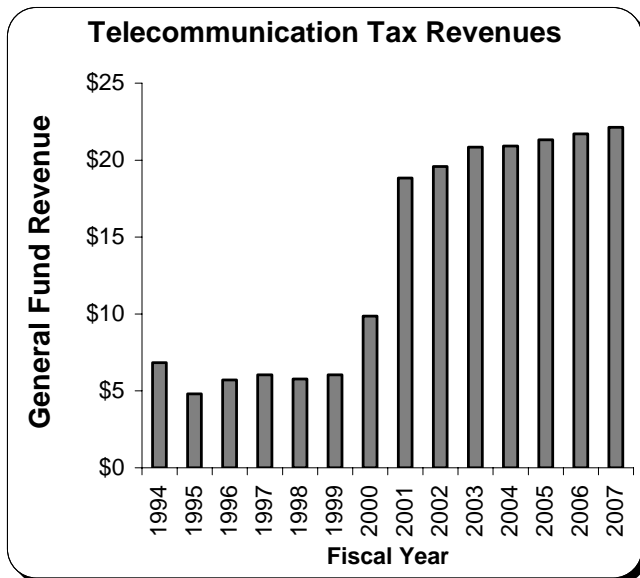
Montana imposes a 3.75% excise tax on retail telecommunications services, which are defined as two-way transmission of information over a telecommunications network that originates *or* terminates in the state, *and* is billed to a customer with a Montana service address. Telecommunications service providers are required to collect the tax and make quarterly payments within 60 days after the end of each quarter. All revenue is allocated to the general fund.

### Historical and Projected Revenue

The telecommunications excise tax replaced the telephone company license tax January 1, 2000.

**Table 1**  
**Telecommunications Excise Tax and Telephone**  
**Company License Tax - General Fund Revenues**  
**(\$ millions)**

	<u>Fiscal Year</u>	<u>General Fund</u>	<u>Percent Change</u>
A	1994	\$6.835	76.82%
A	1995	\$4.801	-29.76%
A	1996	\$5.712	18.98%
A	1997	\$6.045	5.83%
A	1998	\$5.773	-4.50%
A	1999	\$6.037	4.56%
A	2000	\$9.857	63.28%
A	2001	\$18.838	91.12%
A	2002	\$19.594	4.01%
A	2003	\$20.838	6.35%
A	2004	\$20.919	0.39%
<b>F</b>	<b>2005</b>	<b>\$21.314</b>	<b>1.89%</b>
<b>F</b>	<b>2006</b>	<b>\$21.717</b>	<b>1.89%</b>
<b>F</b>	<b>2007</b>	<b>\$22.127</b>	<b>1.89%</b>



It also was intended to replace revenue losses from lower property taxes on telephone company property. Table 1 shows telephone company license tax receipts for FY 1994 through FY 1999; revenue from the two taxes for FY 2000,

when the telephone company license tax was in effect for the first six months and the telecommunications excise tax was in effect for the last six months; telecommunications excise tax receipts for FY 2001 through FY 2004; and forecasts of telecommunications excise tax receipts for FY 2005 through FY 2007.

The large increases in FY 2000 and FY 2001 reflect the transition from the telephone company license tax to the retail telecommunications excise tax. Revenue is projected to grow slowly in the forecast period.

**Forecast Methodology and Projection Calculation**

Growth of telecommunications excise tax revenue is forecast based on national projections of the growth of telecommunications expenditures per person and per dollar of personal income and projections of the growth of population and personal income in Montana.

Table 2 shows average annual growth rates for U.S. telecommunications expenditures, U.S. population age 16 and over, and U.S. personal income. The first row shows average growth rates for FY 1991 through FY 2000. In this period, telecommunications expenditures grew much faster than population or personal income. Telecommunications rates were stable and the expenditure growth was primarily due to rapid growth of usage.

<p style="text-align: center;"><b>Table 2</b>  <b>Growth of US Telecommunications Expenditures</b>  <b>Compared to Growth of Population and Personal Income</b></p>			
-----Average Annual Growth Rate-----			
Fiscal Years	US Telecommunications Expenditures	US Population 16 and Over	US Personal Income
1991 - 2000	7.48%	1.25%	5.54%
2001 - 2004	0.48%	0.34%	3.76%
2005 - 2007	2.44%	1.13%	5.58%

The second row shows average growth rates for FY 2001 through FY 2004. In this period, telecommunications expenditures grew much slower than personal income and only slightly faster than population. The growth of usage slowed and rates fell, especially for long distance. Companies had added long distance capacity hoping to take advantage of opportunities resulting from deregulation, and the industry ended up with significant excess capacity. In addition, many consumers switched to billing plans with a flat monthly fee rather than charges per call or per minute.

Montana telecommunications tax collections have followed the same general pattern. Collections of the telephone company license tax grew by an average of 5.4% per year from FY 1991 through FY 1999, which was the last full fiscal year it was in effect. Growth of the telecommunications excise tax was affected by a credit that was available through FY 2002. Adjusted for this credit, the tax grew by an average of 2.8% per year from FY 2001, the first full fiscal year it was in effect, through FY 2004.

While telecommunications in Montana follows long-term national trends, Montana's year-to-year variations from the trend do not appear to be related to year-to-year variations at the national level. Year-to-year variations in telecommunications tax collections growth are not correlated to variations in national expenditure growth.

The bottom row of Table 2 shows Global Insight's forecasts of growth for FY 2005 through FY 2007. Global Insight predicts that telecommunications usage will begin growing rapidly again but that prices will continue to fall. The result is that telecommunications expenditures are forecast to grow about twice as fast as population but less than half as fast as personal income. This is faster than over the last three years, but much slower than in the 1990s.

The left-hand column of Table 3 shows forecast growth of U.S. telecommunications expenditures per person calculated from the bottom row of Table 2.<sup>1</sup> The middle column shows Global Insight's forecast of the growth of population age 15 and over in Montana. The right-hand column shows the forecast growth rate of telecommunications spending in Montana assuming that the growth rate of spending per person is the same as the national growth rate.<sup>2</sup>

<b>Table 3</b> <b>Population and Telecommunications Spending</b> <b>Forecast Average Annual Growth Rates FY 2004 - FY 2007</b>		
US Telecom Spending per Person Over 15	MT Population 15 and Over	Montana Telecom Spending Population-Based Forecast
1.30%	0.63%	1.94%

<sup>1</sup> The growth rate of expenditures per person is  $(1 + \text{expenditure growth rate}) / (1 + \text{population growth rate}) - 1$ . The growth rate of expenditures as a percent of income is calculated in the same way.

<sup>2</sup> The spending growth rate is  $(1 + \text{spending per person growth rate}) \times (1 + \text{population growth rate}) - 1$ .

The left-hand column of Table 4 shows forecast growth of U.S. telecommunications spending as a percent of personal income calculated from the bottom row of Table 2. The middle column shows Global Insight's forecast of the growth of personal income in Montana. The right-hand column shows the forecast growth rate of telecommunications spending in Montana assuming that the growth rate of spending as a percent of personal income is the same as the national growth rate.

<b>Table 4</b> <b>Income and Telecommunications Spending</b> <b>Forecast Average Annual Growth Rates FY 2004 - FY 2007</b>		
US Percent of Personal Income Spent on Telecom	MT Personal Income	Telecommunications Excise Tax Revenue Income-Based Forecast
-2.97%	4.96%	1.84%

The forecast growth rates shown in Tables 3 and 4 differ by only 0.1%. They are lower than the national growth rate in Table 2 because Global Insight projects both population and income growth to be slower in Montana than nationally through 2007.

This forecast assumes that telecommunications spending and telecommunications excise tax revenue will grow at 1.89%, which is the average of the growth rates in Tables 3 and 4. Revenue is projected to grow at the same rate each year because short-term fluctuations in collections growth are not correlated with national fluctuations in expenditure growth.

Table 5 shows actual FY 2004 collections and forecast collections through FY 2007 with annual growth of 1.89%.

<b>Table 5</b> <b>Telecommunications Excise Tax Revenue</b> <b>(\$ million)</b>		
Fiscal Year	Annual Growth Rate	Revenue
A 2004		\$20.919
<b>F 2005</b>	<b>1.89%</b>	<b>\$21.314</b>
<b>F 2006</b>	<b>1.89%</b>	<b>\$21.717</b>
<b>F 2007</b>	<b>1.89%</b>	<b>\$22.127</b>

### Forecast Risks

The telecommunications industry has seen a number of significant technological and regulatory changes in recent years, and changes of similar magnitude are likely in the near future. Global Insight's forecast of telecommunications expenditure assumes that new technologies and structural changes in telecommunications

markets will continue to drive prices down. If this does not happen, revenue may grow faster than projected.

The major downside risk for the telecommunications excise tax comes from a potential combination of new technology and federal legislation. Congress has twice passed legislation temporarily exempting Internet access charges from state telecommunications taxes. This legislation has expired, but is expected to be renewed and may be made permanent. Montana does not tax separately billed Internet access charges, but does tax charges for bundled services that include both telecommunications and Internet access. Montana also taxes traditional voice communications that are transmitted over the Internet. This technology currently carries a small percentage of calls, but may carry a majority of long distance calls in the future. Some of the Internet tax exemption options that Congress has considered would expand the exemption to preclude states from taxing bundled services that include Internet access or telephone service that uses the Internet, which would reduce telecommunications excise tax revenue.