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Written Testimony of

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Chairwoman Velázquez, Representative Chabot, and members of the Committee, thank you for this opportunity to testify on several issues that the Committee may consider in “Modernizing the Tax Code: Updating the Internal Revenue Code to Help Small Businesses Stimulate the Economy.” I don’t have to tell members of this committee how important small businesses are to the US economy, and how important federal and state tax policies are to the success of small businesses.

My name is Scott Mackey and I am an economist and partner at Kimbell Sherman Ellis LLP. Our firm has grown from 10 employees in 2006 to 22 today, and this growth is directly attributable to advances in communications networks and information technology. We provide state legislative bill tracking services to dozens of companies and trade associations. High-speed communications networks – both wireless and wireline – are the lifeblood of our business, and without the advances in technology over the past 5-10 years, we simply would not be in this business today.

I also provide consulting services to the six largest wireless communications providers on state and local tax policy. This coalition of wireless providers – which includes Alltel, AT&T, Sprint, T-Mobile USA, US Cellular, and Verizon Wireless – seeks to accomplish two major objectives in state legislatures: 1) the reduction or elimination of excessive and discriminatory taxes imposed upon wireless consumers; and 2) the promotion of state and local tax policies that encourage investment in wireless networks.

So I appear today both as a small business owner directly impacted by the federal tax policies I will discuss today, as well as on behalf of CTIA – The Wireless Association® and its member companies. And while few people may think of wireless providers as “small businesses,” having just returned from the CTIA trade show last week, I was struck by the number of small businesses that are rolling out new products and services that are delivered to consumers over wireless networks.

Today, I will discuss two specific issues in the federal tax code that are very important to small businesses that rely on wireless services. I will also briefly touch on federal legislation that would help provide relief from excessive state and local taxes to millions of consumers and small businesses that use wireless service.

- First, we would respectfully request that Congress pass H.R. 5450 introduced by Representatives Johnson and Pomeroy remove cellular phones from the listed property classification. This is a classification that no longer has a place in today's economy, where small businesses are very reliant on wireless services to be effective and efficient in the daily operation of their business.

- Second, at a time when state and local economic development experts are touting broadband as critical to economic competitiveness, extension of the Research & Development credit will help spur continued innovation and advancements in broadband network technologies as well as continued development of applications that work over wireless networks.

- Third, while not directly related to updating the Internal Revenue Code, Congress should support a moratorium on new discriminatory state and local taxes on wireless services, consumers and providers. Currently wireless consumers, including small businesses, already pay **almost double** the rate of taxes on wireless services than the rate imposed on other goods and services. This ban would preclude additional excessive taxes from being added to the consumer's costs for these services.

1) Support and pass H.R. 5450 introduced by Rep. Johnson and Pomeroy to remove cellular phones from the listed property classification.

Cellular phones were included in the "listed property" class (IRC § 280(F)) in 1989 at a time when cellular phones and the cost of such services were very expensive and were primarily restricted to being an executive perk. As listed property, every employee using a phone provided by their employer must maintain a detailed phone log. The log must document every call made and distinguish those that are business calls from personal calls. To substantiate a call was for business use, the employee must identify the date, time and business purpose of the call. Failure to maintain the detailed call log will render the entire monthly service as a taxable fringe benefit to the employee. Subsequently, the employer will be assessed additional payroll taxes and penalties for having failed to comply with these requirements.

In today's wireless world, the cost to use such services has declined dramatically over the years and many businesses utilize this vital technology on a daily basis to help promote productivity and efficiencies within their business. These services are even more critical to many small businesses. As a former Congressional staffer, I know first hand that the work day does not stop at 5:00 pm for Members of Congress and their staffs. Can you imagine keeping a detailed record of every e-mail or phone call received on your wireless device? In today's economy, the distinction between "work" and "leisure" is not always clear.

Not only that, but today's wireless pricing plans do not lend themselves to neat accounting of "work" and "non-work" calls. Price plans that include unlimited calling, unlimited emails, and free nights and weekends make it nearly impossible to assign monetary values to specific calls.

Unfortunately, the Internal Revenue Service (IRS) has recently become more aggressive in auditing businesses for this issue. This is particularly true among nonprofit and tax exempt entities where payroll audits are more common. However, the classification of cellular phones as listed property is a concern for all businesses. The practical effect is that many businesses have stopped subscribing to multi-line business accounts and provide their employees with a taxable allowance to sign up for wireless services that will be used for business purposes. Is that really the right answer? Taxing employees for the value of an expense required for business does not seem fair to me.

That is why the wireless industry, advocating on behalf of consumers, respectfully requests that Congress support and pass H.R. 5450 to remove cellular phones from the listed property classification. This will eliminate an unnecessary and outdated impediment to allowing small businesses to utilize wireless technology to be more productive and efficient in managing the day to day operations of their business.

2) Extend the Research & Development (R&D) credit to help spur continued innovation and advancements in broadband technologies as well as continued development of applications that work over wireless networks.

Technology and innovation have been at the cornerstone of our migration to the service economy that we all benefit from today. Finding ways to develop, improve and expand on technology is critical to the efficiencies and effectiveness we need for our economy to be successful and to continue to grow. Providing an incentive through the R&D credit is essential to encouraging continued investment in innovation and change. This is particularly true in developing and improving upon existing broadband technologies, making them more efficient and reducing the costs to deploy such technologies. Incentives, such as the R&D credit, have helped promote the rapid development of high speed broadband networks and the web-based applications that use these networks. The constant change in broadband technologies has benefited the entire US economy by improving the productivity of American businesses and by lowering prices for such services to consumers through competition.

For example, a recent study by the international technology consulting firm *Ovum and Indepen* found that as much as 80% of the productivity growth in the entire economy in 2003 and 2004 was due to just two sectors: communications and information technology.[1]

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[1] Lewin, David and Roger Entner. Impact of the US Wireless Telecom Industry on the US Economy , Ovum and Indepen, Boston, MA, September 2005.

Economists strongly discourage policymakers from imposing taxes on investment and instead encourage them to find ways to promote such investment. However, in the case of investments in the communications networks that make up the backbone of the Internet, tax policies that discourage investment are especially problematic because of the "network benefits" investments in the advanced communications infrastructure yield. Network benefits are the economic benefits provided by additional infrastructure investments – benefits that extend beyond the direct impact on the affected industry and enhance growth throughout the entire economy based upon the other businesses that utilize these networks.

The data is clear: investments that increase the speed and reach of communications networks improve the productivity of the businesses that use these networks to conduct their business every day. For this reason, tax policies that have the effect of reducing investment in communications networks have negative consequences that extend far beyond the providers directly hit with the new taxes. Letting the R&D credit expire would increase the tax cost of investing in the development of new and innovative technologies for communication networks and slow innovations in productivity-enhancing communications and information technologies.

Much has been written in the last few years about the investments that our economic competitors in China, India, and other nations are making in their communications networks and applications that run over these networks. The competitors recognize that broadband networks are crucial components of a successful strategy to compete in a global economy.

Congressional approval of an extension of the R&D credit would send a clear signal to the markets that long-term investment decisions will not be undermined by increasing the tax cost of investing in developing new technologies. Such a strong, pro-investment signal from the Congress would help ensure that these investments – which have had such an important role in US economic growth and productivity over the last decade – will continue to be encouraged and rewarded. It will send a signal to the markets to invest here, not abroad.

3) Support the moratorium on precluding new discriminatory taxes on wireless services, consumers and providers.

While not directly related to the Internal Revenue Code, another way that Congress can help reduce the total tax burden for small businesses is to support the Cell Phone Tax Moratorium. This legislation would preclude any ***new discriminatory*** state and local taxes from being imposed upon wireless services, consumers and providers for a specified period of time. Much of the testimony provided below comes from a report that I authored, recently published in *State Tax Notes, February 18, 2008,* discussing the tax burden imposed upon the wireless industry and its consumers.

Wireless consumers are subject to a growing number of industry-specific discriminatory taxes and fees on their service. Some states and localities are looking to expand these taxes – many of which originated during a time when the telecommunications industry was characterized by regulated monopolies – even though the wireless marketplace is highly competitive. The wireless industry is characterized by intense price competition and innovative new products and services that have led to dramatic declines in per minute prices and rapid growth in both the number of wireless subscribers and the number of minutes used. Accordingly, these services and their consumers should be taxed like any other competitive goods or services.

A new analysis of the taxes and fees imposed upon wireless services shows that the overall federal, state and local tax burden averages 15.19% compared to the 7.07% imposed upon other competitive goods and services. That represents a tax burden that is more than double the burden imposed upon other goods and services, substantially increasing the cost to provide such services. This additional cost hits the small businesses that are utilizing wireless services in the day to day operation of their business even harder.

Even though economists and policymakers agree that there is no rational economic basis for excessive taxation of the industry and its consumers, wireless consumers continue to pay excessive and burdensome state and local taxes on their wireless service. Some state and local policymakers continue to impose excessive taxes on wireless service because they have imposed excessive taxes on telecommunications services for decades. Rather than reducing excessive taxes on local landline phone companies and their customers, which would reduce existing state and local revenues, some policymakers claim that they have "leveled the playing field" by expanding discriminatory taxes to wireless services.

Supporting the wireless tax moratorium would put a halt to this practice and allow the industry to continue to work with state and local policymakers to continue to pursue the tax reform needed to ensure that all communication services and their consumers are taxed like any other competitive goods and services.

In summary, thousands of small businesses that rely on wireless services to improve their productivity and profitability would benefit if Congress passed H.R. 5450 to remedy the "listed property" issue; extended the expiring R&D tax credit; and adopted a moratorium on new discriminatory state and local taxes on wireless services.

Madame Chair and members of the Committee, thank you again for the opportunity to testify and provide my insight on the importance of these issues to America's small businesses.