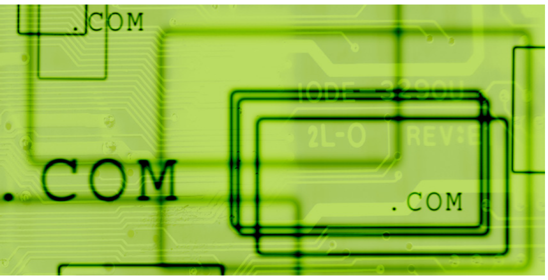
Updated ICC discussion paper on

THE ADVERSE EFFECTS OF DISCRIMINATORY TAXES ON TELECOMMUNICATIONS SERVICES



Discussion paper

Prepared by the ICC Commission on the Digital Economy,
Task Force on Internet and Telecommunications

International Chamber of Commerce
The world business organization

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Updated ICC discussion paper on the adverse effects of discriminatory taxes on telecommunications services

Despite the current severe economic crisis and the urgent need to trigger private investment in the ICT sector, a number of countries apply taxes to telecommunications goods and services at higher levels than for other goods and services. These burdensome and discriminatory taxes deter the adoption and use of broadband, mobile and other advanced ICT sector tools that are major drivers of development and growth in the information-based, but currently crisis-shaken, economies of the 21st century. The World Bank has found, based on an econometrics analysis of 120 countries, that each 10% increase in broadband penetration increases economic growth by 1.3%[1]. Unfortunately, the tax treatment of telecommunications goods and services sometimes reflects the out-dated view that communications services should be taxed as luxuries affordable only by the rich[2] – rather than as essential services for all, which they are today. Because telecommunications taxes often have the most stifling impact on the low income consumers who represent the greatest opportunity for achieving universal adoption of fixed or mobile broadband, these taxes are directly inconsistent with both Millennium Development Goals and the public policy of most countries that have implemented the taxes.

High taxes on communications services frustrate efforts to increase telecommunications service deployment by raising consumer prices and reducing demand for these services. A study by US economists Greg Sidak and Allan Ingraham in 2004 found that each 1% increase in the price of wireless service reduces consumer demand by between 1.12% and 1.29%[3]. Reductions in consumer demand reduce the cash flows available for investment in the build-out of telecommunications networks and the development of new services. With information and communications technologies (ICTs) now playing a key role in stimulating increased productivity growth in all economic sectors, tax policies that reduce or slow investment in telecommunications infrastructure therefore reduce or slow the achievement of the broader economic benefits that follow from that investment.

Remedying the discriminatory tax treatment of telecommunications goods and services may reduce tax receipts in the short-term, but the longer-term increase in competitiveness and productivity, in GDP growth and employment based on more investments (in particular in next generation networks) on expanded use of advanced capability devices, on service demand and increased broadband penetration resulting from these tax reductions is likely to counteract this loss of tax revenues over time. Indeed, a study conducted for GSMA in 2008 estimates that many countries in sub-Saharan Africa would increase their longer-term tax revenues by removing or reducing their existing high taxes on mobile services, as the result

[1] *World Bank, Information for Communications and Development 2009, Extending Reach and Increasing Impact, at 5.*

[2] *See, e.g. GSM Association, Global Mobile Tax Review 2006-2007, at 48 (quoting statement by Maria del Rosario Guerra de la Espriella, Minister of Communications Colombia, that "mobile communications is considered a luxury good and has a special VAT rate of 20%, compared to common goods and services which are charged at 16% … Today in Colombia, because of its high use and penetration, mobile telephony is now a basic consumer good, but it is taxed as a luxury good.")*

[3] *Allan T. Ingraham & J. Gregory Sidak, Do States Tax Wireless Services Inefficiently? Evidence on the Price Elasticity of Demand, Virginia Tax Review, Fall 2004, at 249-261 (finding that reducing the taxation of wireless services by one dollar would improve the economic welfare by between $1.23 and $1.95).*

of the beneficial impact on tax receipts from the resulting increase in mobile penetration[4]. After the GSMA released this study, the Kenyan government in 2009 removed import duties and sector-specific sales taxes on mobile hand-sets.

Recently, the European Commission instructed two European Union member states to abolish taxes on telecommunications services used to subsidize free public broadcasting, asserting the laudable conclusion that any specific taxes on telecommunications operators should be collected only to cover the costs of regulating the telecommunications sector. As well, other types of discriminatory taxation also harm the growth of telecommunications services and the resulting economic benefits, by decreasing demand and network utilization. El Salvador, for example, is unfairly shifting its domestic tax burdens for funding social programmes that are unrelated to telecommunications, to be paid by telecommunications consumers in other countries by adopting a tax solely on inbound international calls to that country of USD 0.04 per minute, while imposing no such tax on El Salvador's outbound international or domestic calls. In contrast, both the United States and the European Union have declined to impose universal service fees on inbound international calls, both for telecommunications-related Universal Service Fund programmes, and also for any other government programmes.

A similarly misplaced approach for raising domestic revenue is reflected in the ITU-T Recommendation D.156 adopted in 2008 which recommends that developing countries consider requiring the addition of a "network externality" premium to termination rates for inbound international calls from developed countries to be used for network build-out in developing countries. Twenty-eight ITU Member States, including most members of the OECD, have entered reservations against the ITU Recommendation and have stated that they will not apply it. According to an analysis by the OECD, "such proposals fail to appreciate that imposing a mechanism, which for all practical purposes is incompatible with a market-based system, will act as a constraint on network expansion. … [which] has occurred through competition and in the face of declining international call termination charges, which have been moving toward cost, and not through subsidies from high, non-cost based, international call termination charges."[5] Additionally, the United States Trade Representative (USTR) has noted that the Recommendation appears to encourage potentially WTO-inconsistent action in several important respects.[6]

For the reasons stated above, ICC recommends that countries minimize the taxes imposed on telecommunications goods and services to support investment-driven increases in growth and employment. Far from being luxuries, the tools from this sector bring the building blocks of opportunity to the global information-based economy. Increasingly, public policy is oriented towards connecting the unconnected in order to achieve 100% adoption of advance telecommunications services. Any taxes that have the effect of impeding that goal merit

[4] *GSMA, Taxation and the Growth of Mobile Services in Sub-Saharan Africa, May 2008 (finding that the removal of all non-VAT phone ownership taxes in twenty countries in sub-Saharan Africa would increase tax receipts from mobile services, as well as increasing mobile subscribership by 43.4 million, in addition to the significant benefits to economic development from this increased mobile penetration).*

[5] *OECD Working Party on Communication Infrastructures and Services Policy, Network Externality Premiums and International Telecommunication Traffic Exchange, Apr. 15, 2009, at 9.*

[6] *Office of the U.S. Trade Representative, Results of the 2010 Section 1377 Review of Telecommunications Trade Agreements, at 4,* *http://www.ustr.gov/sites/default/files/2010%2003%2025%201377%20REPORT%20FINAL.pdf*

reconsideration.

The following are further examples of the discriminatory taxes imposed on telecommunications goods and services in some countries. These all represent opportunities for ICC to work with national governments to avoid, minimize or repeal the identified tax:

Argentina: Pending legislation, Argentina seeks to increase internal taxes on mobile handsets to a nominal rate of 17% for devices not produced in the Tierra de Fuego special economic area. Since 98% of mobile devices are produced outside this area; the legislation is likely to have a major effect in reducing mobile handset ownership and in turn on mobile service subscribership.

Bangladesh: Bangladesh imposes a SIM card tax of Tk. 800 (USD 11.6) for each new mobile subscriber that functions as a significant obstacle to the connection of new users in the world’s seventh most populous country.

Brazil: Telecommunications services in Brazil are generally subject to retail taxes of 25% (or higher in some states). However, in May 2012 the State of Amazonas increased its retail tax (ICMS) for telecommunications services from 25% to 30%. It is encouraging, however, that some efforts are being made to reduce these taxes. The State of Sao Paulo last year removed its 25% retail tax for Internet services of 256 kilobits per second or more that charge under USD 17 per month.

Colombia: In 2012, the Colombia tax authorities presented a tax reform that would result in income obtained from the render of international television service being considered Colombian source income and subject to 33% withholding tax. This law dramatically changes the current law which does not tax the provision of programming or television services from outside of Colombia.

Croatia: On 1 August 2009, a 6% fee on invoiced services for mobile SMS, MMS, and voice services including roaming services entered into force in Croatia. The fee is imposed only on infrastructure based mobile operators and was part of anti-recession legislation that sought to support economic recovery by transferring funds to more adversely-affected economic sectors. A sunset clause has not been built in. This 6%-mobile fee was abolished by the former Croatian Government effective 1 January 2012. The current Croatian Government re-introduced the fee effective 26 January 2012, and then re-abolished it effective 10 July 2012.

El Salvador: As described above, in August 2008, El Salvador approved Decreto No. 651, which expressly seeks to shifts the funding costs for domestic social programmes away from domestic end users in El Salvador and to impose these costs on consumers in other countries by taxing inbound international calls. The introductory paragraph to the legislation states: “Charges for interconnection services for inbound calls from outside the country are paid for outside the country and therefore have no impact on the cost of calls made by domestic end-users because these charges are not made part of the domestic charges.” Calls from other Central American countries are exempt from the tax. The United States Trade Representative (USTR) has questioned whether this exemption complies with the Most-Favoured-Nation requirement of the WTO General Agreement on Trade in Services (GATS). USTR has noted that the tax also “raises questions regarding El Salvador’s adherence to its commitment in the GATS Annex on Telecommunications (GATS Annex) and the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR) to ensure reasonable access to and use of its public telecommunications network."[7]

France: On 5 March 2009, France introduced a tax of 0.9% on electronic communication service provider revenues, including telecom, mobile and Internet service revenues (and 3% on the advertising revenues generated by privately run broadcasters), to fund public television following the cessation of advertising on those channels. The new tax is estimated to produce annual revenue of EUR 400 million. On 30 September 2010, the European Commission announced that it considers the tax to be incompatible with European Union telecom rules requiring specific charges on telecom operators to be specifically and directly related to the costs of regulating the telecoms sector and asked France to abolish the tax. [8] On 14 March 2011, the European Commission decided to refer France to the EU's Court of Justice because they continue to impose specific charges on the turnover of telecoms operators in breach of EU law.

Greece: Since 1998, a tax has been applied to the monthly bills of post-paid mobile subscribers. Until 2009, there were three different rates (EUR 2, EUR 5, and EUR 10) depending on the amount of the total monthly bill. Pre-paid subscribers did not pay this tax. In July 2009, a new law introduced a 12% tax on prepaid mobile subscriptions and also increased the tax rates on post-paid subscriptions to 12%, 15%, 18%, and 20%, depending on the amount of the total monthly bill. In addition, the Greek government had imposed a special levy on the higher amount of taxable income based on IFRS (if applicable) or Local Gaap, basically targeting all companies for the fiscal years 2008 and 2009, however, with a differentiation in the impact applicable as part of its measures to regain fiscal health.

Honduras: In April 2012, the National Congress of Honduras introduced an amendment to Article 75 of the Telecommunications Law, adding a tax for all telecommunications service providers except Hondutel. The tax is variable, depending on the level of income of the company, but the average level of new tax on mobile service providers is an additional 1.5%.

Hungary: In October 2010, the Hungarian Government announced the introduction of a new 'crisis tax' to be imposed on the telecom, energy and retail sectors, with EUR 230 million to be collected from the telecom sector, to bring the country's budget deficit in line with European Union rules. ETNO, the European Telecom Network Operators' association, has called on the Hungarian Government to reconsider this proposal, noting its concern that this special tax is not consistent with EU telecoms rules, as recently stated by the European Commission in its decision on the French and Spanish telecoms taxes. The European Commission opened infringement proceedings against Hungary concerning the telecoms tax in March 2011. It followed this up in September 2011 with a reasoned opinion formally asking Hungary to abolish the telecoms tax. On 22 March 2012, the European Commission decided to refer Hungary to the EU's Court of Justice because it continues to impose a specific tax on the turnover of telecoms operators in violation of EU rules. On 12 October 2012, the EU Commission has brought the case to the European Court of Justice. Since 1 July 2012

[7] *Office of the U.S. Trade Representative, Results of the 2010 Section 1377 Review of Telecommunications Trade Agreements, at 3.*
http://www.ustr.gov/sites/default/files/2010%2003%2025%201377%20REPORT%20FINAL.pdf
[8] *See Europa Press Release, Digital Agenda: Commission Requests France and Spain to End Telecoms Taxes,' 30 September 2010.*

Hungary has been applying a new tax upon telecommunications operators which is expected to raise HUF 50 billion (ca. EUR 170 million). This new telecommunication tax is payable by fixed and mobile telecommunications operators and is levied at a rate of HUF 2 per minute upon all qualifying voice calls made over the operators' networks, and HUF 2 per SMS upon all qualifying SMS. Certain exemptions apply to particular types of call, and overall limits apply to the taxable charge attributable to any individual subscriber. A sunset clause is not built in. Currently, there are some discussions about the implementation of a new 'utility tax' to be issued over wires and pipelines underground raising some HUF 30 billion in additional revenue.

India: India's regulatory charges on telecommunications services include a uniform license fee of 4% (Internet Service Provider License), 7% (International Long Distance and National Long Distance License) and 9%, 8%, 7% (three different categories of Access License) of annual gross revenue, depending on the license provided. There is also a spectrum charge of 3% - 8% of annual revenue. Department of Telecommunications (Licensor) will replace these various charges by implementing a uniform license fee of 8% across all license categories from April 2013 onwards. Apart from the above, there is a service tax of 12.36% on the revenue, payable by any licensee, which is passed on to subscribers. The service tax is levied pursuant to a decision of the Ministry of Finance.

Italy: Post-paid mobile services are taxed at a rate of EUR 5.16 per month. Tax-deductible business post-paid mobile subscriptions are taxed at a rate of EUR 12.91 per month.

Malawi: In June 2012, the Finance Ministry announced an intended increase in the corporate tax on the wireless sector from 30% to 33%.

Mexico: As of 2010, the services rendered through a public network of telecommunications (i.e. pay-tv services, certain telephone services) became subject to a 3% excise tax. The access to Internet services, interconnection services and rural and public telephone services are exempt, but the tax affect triple play package.

Montenegro: Among a bunch of measures to improve fiscal health Montenegro has introduced a new mobile tax of EUR 1 per each active SIM card a month, and a new TV tax of EUR 1 per TV connection a month which is levied among others on IPTV connections. The other services being levied by this "Law on Taxes on Access to Certain Services of General Interest and Tobacco Consumption" are electricity and tobacco. The mobile tax alone is supposed to raise more than EUR 8 million p.a. These new taxes shall be abolished by the end of 2013.

Nigeria: The Nigerian wireless sector has highlighted that the multiple taxation system focused on the industry has negatively impacted the ability to invest in infrastructure such as towers/base stations. The industry has built only 20,000 of the estimated 70,000 towers needed across the country. Some analysts estimate that the cumulative impact of the multiple taxes imposed on Nigerian mobile operators is close to a 35% rate, which is double the global average.

Serbia: Following a decision of the Government of Serbia, mobile telephony services users pay an additional 10% tax since 1 June 2009. The Government's "Mobile Phone Tax", applied according to the instructions of the Ministry of Finance, is a temporary measure and refers to all calls, sending of text (SMS) and multimedia (MMS) messages as well as data transfers (Internet traffic), and special services, both in the country and abroad. The tax, payable on service rates, VAT excluded, is collected on behalf of the state by all three operators in the territory of Serbia. For post-paid subscribers, the tax is added to monthly traffic total and presented in the bill as a separate item. Prices of top-ups for prepaid subscribers will not change nominally, since the new tax will be included in the price. The tax will also be payable on special services for all subscribers, including a SIM card or number of replacements, special numbers, and mailing of call specifications to the subscriber's home address.

Slovakia: The Slovak Parliament adopted a new Act on the Special Levy on Undertakings in Regulated Industries, effective in September 2012. Companies in regulated sectors -- including telecommunications, health care, energy and postal -- are subject to additional taxation in 2012 and 2013. Prime Minister Fico suggested that he would seek to collect a total of EUR 200 million (EUR 100 million a year) from companies in these sectors. The Special Levy rate amounts to 4.356% p.a. and is imposed on earnings before tax for all companies with profit in excess of EUR 3 million.

Spain: On 31 August 2009, Spain introduced a tax of 0.9% of gross retail revenues of telecommunications operators providing media services (and 3% in the case of free to air television stations) to finance RTVE, the public service broadcaster, following the removal of advertising from public service television. On 30 September 2010, the European Commission announced that it considers the tax to be incompatible with European Union telecommunications rules requiring specific charges on telecommunications operators to be specifically and directly related to the costs of regulating the telecommunications sector, and asked Spain to abolish the tax. On 14 March 2011, the European Commission decided to refer Spain to the European Union's Court of Justice because they continue to impose specific charges on the turnover of telecommunications operators in breach of EU law.[9] Spain also levies a tax of 1.5% of gross telecommunications operator retail revenues to finance local municipalities.

Sudan: In December 2011, to compensate for reduced tax income from oil revenue, the Sudanese government increased the telecommunications tax on revenue from 20% to 30%, and increased tax on profits from 15% to 30%.

Turkey: Some of the highest taxes on telecommunications services in the world are collected in Turkey, where mobile services are subject to total taxes of more than 40%, according to several studies.[10] These taxes include a special communications tax, in addition to value added tax and a Treasury share premium. The special communications tax rates are 25% for mobile services, 15% for fixed telecommunications services, and 5% for Internet services. Turkey also charges additional taxes and fees related to mobile subscriptions and usage.

[9] *See Europa Press Release, Digital Agenda: Commission Requests France and Spain to End 'Telecoms Taxes,' 30 September 2010 and Digital Agenda: Commission refers France and Spain to Court over 'telecoms taxes' 14 March 2011.*
[10] *Today's Zaman, Taxes Account for Nearly Half of Cell Phone Bills, 4 August 2008; Turkish Daily News, Turkey Champion of High Mobile Phone Tax Rates, 26 July 2008; GSMA, Global Mobile Tax Review 2006-2007 (finding Turkey to have the highest cost of tax as a percentage of the total cost of mobile ownership at 45%, and one and a half times greater than the next highest country).*

Uganda: This country imposes a 12% tax on mobile services and a 5% tax on land line usage.[11]

United States: The United States declares its localities tax communications services at more than twice the rate of other industries.[12] Often, these higher transaction tax rates only apply to traditional providers of communications services creating competitive disadvantage and distorting consumer behaviour. In addition, the multitude of various state, county and city taxes, utility fees, license fees, and user fees are confusing, expensive, and difficult for telephone companies to comply with and administer. This complexity and the lack of a central repository of taxes, fees and their rates is a significant barrier for competitors to enter the market. Monopoly-era property taxes on incumbent telephone companies remain in place in many states, and have been extended in some cases to providers of wireless telecommunications, imposing exceptionally high and discriminatory assessment ratios, tax rates, or valuation on telephone-company-owned property. In addition, these property taxes do not encumber communications companies that do not qualify as telephone companies, and thus they provide a competitive disadvantage to traditional telecom providers. Furthermore, US interstate telecom services are currently subject to federal universal service fund charges of 13.6%.

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[11] *Wireless Federation, Uganda's Telecom Penetration to Reach 17 million by 2012, 23 April 2009.*

[12] *See 2004 State Study and Report On Telecommunications Taxation, Council on State Taxation, March 2005, at 3-4 (showing an average effective rate of state and local transaction taxes for telecommunications services of 15.17%, compared to 6.12% for general businesses).*

ICC Commission on the Digital Economy

Business leaders and experts develop and promote the continued and stable growth of the Digital Economy, and further adoption of its underlying ICT foundation, through regulatory advocacy of key business positions and best practices through ICC's Commission on the Digital Economy.

Through its members who are ICT users and providers from both developed and developing countries, ICC is recognized in expert circles as the global consensus voice for private sector expertise on policy matters that drive the Digital Economy. It also provides the ideal platform for developing global voluntary rules and best practices for this area of interest to companies worldwide. Dedicated to the expansion of secure ICT-facilitated trade, ICC champions the liberalization and regulatory harmonization that are required to achieve a free flow of information across all borders.

ICC led and coordinated the input of business around the world to the United Nations World Summit on the Information Society (WSIS), Geneva 2003, Tunis 2005, and continues this effort in the activities established in the Tunis Agenda through its initiative, Business Action to Support the Information Society (BASIS http://www.iccwbo.org/basis).

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The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the 20th century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rule setting, dispute resolution, and policy advocacy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice. ICC also offers specialized training and seminars and is an industry-leading publisher of practical and educational reference tools for international business, banking and arbitration.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on relevant technical subjects. These include anti-corruption, banking, the digital economy, marketing ethics, environment and energy, competition policy and intellectual property, among others.

ICC works closely with the United Nations, the World Trade Organization and intergovernmental forums including the G20.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with ICC members in their countries to address their concerns and convey to their governments the business views formulated by ICC.

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