

CRS Report for Congress

Received through the CRS Web

The Federal Excise Tax on Telephone Service: A History

Updated June 30, 2005

Louis Alan Talley
Specialist in Taxation
Government and Finance Division

Federal Excise Tax on Telephone Service: A History

Summary

The federal excise tax on telephone service applies equally to general and toll (local and long-distance) telephone service. The tax is levied at a 3 percent rate and is a permanent part of our revenue structure.

The tax was first imposed in 1898 because of revenue needs brought about by the Spanish-American War. This initial tax of 1 cent for calls costing more than 15 cents applied only to long-distance service and was repealed in 1902. Revenue needs to prepare for World War I saw the reintroduction of the tax in 1914. The tax rate was increased at the time America entered the first world war. It was not until 1924 that the tax was again repealed.

A depression reduced federal government receipts and led to the reintroduction of the tax in 1932. In 1941, just before America entered World War II, rates were increased and the tax was extended so that it also applied to local telephone service for the first time. During the war, tax rates rose to 15% on local telephone service and 25% on long distance service when the charge was more than 24 cents. Telephone taxes have been continuously collected since this period.

A review of federal excises in 1965 brought about a reduction in the tax rate and a scheduled date for elimination in 1969. However, revenue needs resulting from the Vietnam conflict not only caused extension of the tax but resulted in higher tax rates. Large budget deficits in the 1970s, 1980s, and 1990s resulted in repeated extensions and postponement of the tax's repeal. In 1990 the tax became a permanent part of the federal revenue structure at a 3% tax rate.

In the current Congress a confluence of events has led to renewed interest in the federal excise tax on communication services. The Joint Committee on Taxation has issued a report including three possible options for changes to the tax. A study by the Congressional Budget Office discusses the possible elimination of the tax. Bills in both the House and the Senate have been introduced calling for the tax's repeal (including H.R. 1898). Any additional changes made to the tax will be reflected in an updated report.

Contents

Spanish-American War	1
Prelude to World War I	1
World War I	3
The Great Depression	3
World War II	4
Codification of the Internal Revenue Code	4
Vietnam Conflict	5
Recent Developments	7

List of Tables

Table 1. Brief Legislative History of the Telephone Excise Tax	8
--	---

The Federal Excise Tax on Telephone Service: A History

It is a popular but erroneous belief that the federal excise tax on telephone service¹ is earmarked for defense spending. In fact, the revenues that flow from this tax go into the General Fund of the United States and are used to pay for general government expenditures — whether for national defense or for non-defense programs. However, there are reasons why this erroneous belief developed. The history of the telephone excise tax shows that it has been enacted primarily at times when our national defense requirements have sharply increased — such as during the Spanish-American War, World Wars I and II, and when our military commitments intensified during the Vietnam conflict.

This report traces the history of the federal excise tax on telephone service from 1898 to the present. The public laws/federal legislation addressing the tax are listed and summarized in Table 1 at the end of this report. The text provides the historical context for the major legislation affecting the telephone excise tax. The history shows that the tax has been intermittent. Over the last century, the tax has changed many times and in many ways.

Spanish-American War

In late April 1898, Congress passed a resolution declaring that a state of war had existed since April 21, 1898, between the United States and Spain. Although the Spanish-American War was short, its financing needs resulted in a federal budget deficit. In the landmark case *Pollock v. Farmers Loan and Trust Company* the Supreme Court had nullified the income tax of 1894. Many in Congress felt that tariff increases could create too much disturbance with industry. As a result, the leaders in Congress felt that the revenues required for military expenditures either should come from increases in existing domestic taxes or supplements of new taxes of the same type. Thus, an excise tax on telephone service was introduced for the first time in 1898.² The tax remained in place until it was repealed in 1902.

Prelude to World War I

In August 1914, war broke out in Europe resulting in a precipitous fall in imports to the United States from Europe. One result from the fall in imports was

¹ 26 United States Code ¶ 4251.

² 30 Statutes at Large 460 [P.L. 55-133.]

that business profits were reduced, and revenues from the corporation income tax declined. This fall in imports also reduced the federal government's customs receipts. On September 4, 1914, President Wilson called upon Congress to raise an additional \$100 million through "internal" taxes (in contrast to customs duties). These revenues were needed not only because of the loss of revenues but also because of added federal spending related to the war being fought in Europe.³ In response, Congress passed H.R. 18891⁴ commonly known as the *Emergency Internal Revenue Tax Act of 1914*.⁵ The act was mostly a renewal of the excises contained in the *Spanish-American War Revenue Act*. It included a tax of 1 cent for telephone calls costing more than 15 cents.⁶ The taxes instituted under this act were initially set to expire on December 31, 1915. However, on December 17, 1915, Congress passed a joint resolution⁷ that continued the taxes instituted in 1914 "in full force and effect until and including December thirty-first, nineteen hundred and sixteen."⁸ After that time, while revenue needs continued (for "preparedness"), the *Revenue Act of September 1916*⁹ did not extend the tax on telephone service.¹⁰

³ Congress appropriated monies to bring home stranded Americans and to establish a war-risk insurance bureau for American businesses.

⁴ An Act to increase the internal revenue, and for other purposes.

⁵ 38 Statutes at Large 761. [Public, No. 217.]

⁶ Telegraph and telephone messages: It shall be the duty of every person, firm, or corporation owning or operating any telegraph or telephone line or liens to make within thirty days after the expiration of each month a sworn statement to the collector of internal revenue in each of their respective districts, stating the number of dispatches, messages, or conversations originated at each of their respective exchanges, toll stations, or offices, and transmitted thence over their lines during the preceding month for which a charge of 15 cents or more was imposed, and for reach of such messages or conversations the said person, firm, or corporation shall collect from the persons paying for the message or conversation a tax of 1 cent in addition to the regular charges for the message or conversation, which tax the said person, firm, or corporation shall in turn pay to the said collector of internal revenue of their respective districts: *Provided*, That only one payments of said tax shall be required, notwithstanding the lines of one or more persons, firms, or corporations shall be used for the transmission of each of said messages or conversations: *Provided further*, That the messages or dispatches of the officers and employees of any telegraph or telephone company concerning the affairs and service of the company, and like messages or dispatches of the officials and employees of railroad companies sent over the wires on their respective railroads shall be exempt from this requirement: *And provided further*, That messages of officers and employees of the Government on official business shall be exempt from the taxes herein imposed upon telegraphic and telephonic messages.

⁷ H.J.Res. 59 [Pub. Res., No. 2].

⁸ 39 Statutes at Large 2. [Pub. Res., No.2.]

⁹ 39 Statutes at Large 792. [Public, No. 271].

¹⁰ The tax law for individuals was completely rewritten, and the first permanent estate tax, the first war-profits tax, and the first tax on corporation capital stock were all included in the law.

World War I

With the entrance of the United States into World War I, revenue needs were greatly increased. Both parties worked together to produce a tax bill. Included in the *War Revenue Act of October 3, 1917* was a tax of “5 cents upon each telegraph, telephone, or radio, dispatch, message, or conversation, which originates within the United States, and for the transmission of which a charge of 15 cents or more is imposed.”¹¹ Work on the *Revenue Act of 1918*¹² had nearly been completed when the Armistice was signed on November 11, 1918. Although World War I had ended, Congress recognized budget expenditures could be expected to decline in the long term but that reductions in expenditures would not occur in the short term. Pay for our military forces could be expected to continue for some time and there was a need to provide capital for reconstruction to our allies in Europe. Thus, this tax measure was redrafted. The redrafted Act not only continued the telephone excise tax but did so at increased rates that were graduated for the first time.¹³ While this act is referred to as the *Revenue Act of 1918*, it was not passed until early in 1919. The tax continued until it was repealed in 1924.

The Great Depression

Today’s current telephone tax, derives from the *Revenue Bill of 1932*. Since then, it has been reauthorized 29 times. The 1932 Act was passed in response to a federal budget deficit brought about because of a decline in income tax receipts caused by an economic depression rather than as a result of war. Initially the tax was levied only on interstate (long-distance) service. The telephone excise tax was extended five times (between 1933 and 1941) before the tax was first applied to local telephone service.

¹¹ 40 Statutes at Large 300. [Public, No. 50.]

¹² 40 Statutes at Large 1057. [Public, No. 254.] The law became effective February 24, 1919.

¹³ In the case of each telegraph, telephone, cable, or radio, dispatch, message, or conversation, which originates on or after such date within the United States, and for the transmission of which the charge is more than 14 cents and not more than 50 cents, a tax of 5 cents; and if the charge is more than 50 cents, a tax of 10 cents: *Provided*, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons are used for the transmission of such dispatch, message, or conversation; and (g) a tax equivalent to 10 per centum of the amount paid after such date to any telegraph or telephone company for any leased wire or talking circuit special service furnished after such date. This subdivision shall not apply to the amount paid for so much of such service as is utilized (1) in the collection and dissemination of news through the public press, or (2) in the conduct, by a common carrier or telegraph or telephone company, of its business as such.

World War II

Just prior to the entrance of the United States into World War II, the *Revenue Act of 1941*¹⁴ was passed into law. In addition to increasing the rate on long distance calls, it also imposed the tax on “general” or local telephone service for the first time. The rate of tax for local telephone service was set at 6 percent of the amount paid by subscribers while that for long distance calls was set at 5 cents for each 50 cents or fraction thereof, if the cost of the message was greater than 24 cents. Other legislation was subsequently enacted during World War II — the *Revenue Act of 1942*¹⁵ and the *Revenue Act of 1943*.¹⁶ The tax rates on telephone service reached their all time high under provisions of the *Revenue Act of 1943*.¹⁷ Rates were 15 percent on local telephone calls and 25 percent (on messages which cost more than 24 cents) on long distance calls. The *Revenue Act of 1943* also provided for the increased excise tax rates to expire. In the case of the excise taxes on telephone service, the law provided that the increased rates would end six months after the “date of termination of hostilities in the present war.” The law defined the termination date as that date proclaimed by either the President or the date specified in a concurrent resolution of the two Houses of Congress, whichever is the earlier. In a reversal of this position, the *Excise Tax Act of 1947*¹⁸ continued the rates indefinitely.

Codification of the Internal Revenue Code

With the revision of the *Internal Revenue Code of 1954*¹⁹ the levies imposed on both local and long distance calls (for messages costing more than 24 cents) were reduced. In the case of local calls the rate was reduced from 15 percent to 10 percent and on long distance calls the rate was reduced from 15 percent to 10 percent. The *Excise Tax Technical Changes Act of 1958*²⁰ made no changes in the tax rate on telephone calls but did remove the 24 cents limitation first provided for in 1942. As such, both local and long-distance calling were subject to the same tax rate for the first time. Prior to passage of this act, the terminology of the tax was somewhat different. What is now called a tax on general telephone service was then known as a tax on local telephone service, and what is now called a tax on toll telephone service was known as a tax on long distance telephone service.

¹⁴ 55 Statutes at Large 714. [P.L. 77-250.]

¹⁵ 56 Statutes at Large 975. [P.L. 77-753.]

¹⁶ 58 Statutes at Large 61. [P.L.. 78-235.]

¹⁷ While called the *Revenue Act of 1943* the legislation was not passed into law until 1944.

¹⁸ 61 Statutes at Large 12. [P.L. 80-17.]

¹⁹ 68A Statutes at Large 503. [P.L. 83-591.]

²⁰ 72 Statutes at Large 1289. [P.L. 85-859.]

The *Tax Rate Extension Act of 1959*²¹ provided for the termination of the tax on local telephone service on July 1, 1960. However, a series of one-year extensions²² was subsequently enacted²³ each year until 1965 when the *Excise Tax Reduction Act*²⁴ became law. In 1965 Congress enacted comprehensive legislation which repealed many existing federal excise taxes and authorized the reduction, and in some instances, the gradual reduction and ultimate repeal of other excises over a period of years. This act authorized the reduction of the 10 percent tax on local and long distance telephone service to 3 percent which became effective on January 1, 1966. In addition to the reduced rate, the act provided for the gradual reduction and elimination of the tax on January 1, 1969.

Vietnam Conflict

By 1966, however, the federal government's revenue requirements had increased due to acceleration of the Vietnam conflict. President Johnson requested that Congress enact legislation to restore the rate of the telephone excise tax to the 10 percent rate in effect prior to January 1, 1966, and that successive reductions which had been authorized by the *Excise Tax Reduction Act of 1965* be deferred. Accordingly, Congress enacted the *Tax Adjustment Act of 1966*²⁵. That act authorized the restoration of the former 10 percent rate on these services beginning on April 1, 1966, for a two-year period (until April 1, 1968), at which time it was to be reduced to 1 percent, before repeal on January 1, 1969. Representative Wilbur D. Mills, then Chairman of the House Committee on Ways and Means, made the following statement during House Committee on Appropriations hearings on the Department of Treasury and Post Office and Executive Office of the President Appropriations for 1968: "It is clear that Vietnam and only the Vietnam operation makes this bill necessary" (page 547).

Again in 1967 President Johnson urged postponement of scheduled reductions in telephone excise taxes as part of his tax program designed to meet the rising cost of the Vietnam conflict and increasing domestic needs. A Joint Congressional Resolution was approved which temporarily extended the 10 percent rate from March 31, 1968 until April 30, 1968. This temporary extension provided Congress time to complete action on the *Revenue and Expenditure Control Act of 1968*.²⁶ The 1968 act continued the 10 percent tax retroactively from April 30, 1968, until December

²¹ 73 Statutes at Large 158. [P.L. 86-75.]

²² President Eisenhower in his budget messages of 1960 and 1961 recommended extension of the telephone excise tax.

²³ The following one-year extensions of the tax were enacted: to July 1, 1961 by P.L. 86-564; to July 1, 1962 by P.L. 87-72; to July 1, 1963 by P.L. 87-50, to July 1, 1964 by P.L. 88-52; and to July 1, 1965 by P.L. 88-348.

²⁴ 79 Statutes at Large 136. [P.L. 89-44.]

²⁵ 80 Statutes at Large 66. [P.L. 89-368.]

²⁶ 82 Statutes at Large 265. [P.L. 90-364.]

31, 1969, with provision for its subsequent reduction and repeal by calendar year 1973.

Passage of the *Tax Reform Act of 1969*²⁷ again granted a one-year extension (this time until December 31, 1970) of the telephone tax at the rate of 10 percent. With passage of the *Excise, Estate and Gift Tax Adjustment Act of 1970*²⁸ the 10 percent rate was extended through calendar years 1971 and 1972. The tax was then to be reduced by 1 percent each year until the tax was scheduled for repeal on January 1, 1982. However, prior to repeal, the tax was extended in 1980 at a 2 percent rate until 1982 when it was scheduled to be reduced to 1 percent before repeal in 1983.²⁹ In 1981 the tax was extended again. This time the tax was extended at the 1 percent rate for two additional years with repeal scheduled for 1985.³⁰ However, the following year, 1982, the tax was increased to a 3 percent rate, with repeal rescheduled for the beginning of calendar year 1986.³¹

In April 1984 both the House of Representatives and the Senate passed legislation calling for a continuation of the current excise tax on telephone service at a 3 percent rate for an additional two years. The legislation enacted provided for repeal in 1988.³² However, before repeal the tax was again extended at the 3 percent rate this time for an additional three years.³³ During this period, the Office of Tax Analysis of the U.S. Department of Treasury issued a report (August 1987). The report concluded that the communications excise tax caused economic distortions and inequities between households and that there was no policy rationale for retaining the tax. The report also suggested three alternatives to the private communication service exemption if the tax were to be extended, since current law created differential tax treatment of private and nonprivate communication services. In the report, there was a call for modifying or repealing some of the exemptions of current law (if the tax was to be extended), since the exemptions had not been reviewed in recent years.

President Bush submitted his budget proposal for FY1991 on January 29, 1990. That proposal called for the permanent extension of the telephone excise tax at the prevailing rate of 3%. Since the tax had been a continuous revenue source since 1932 and because of large continuing budget deficits, Congress concurred with the President's recommendation and made the tax a permanent part of our tax revenue structure with the enactment of the *Revenue Reconciliation Act of 1990*.³⁴

²⁷ 83 Statutes at Large 660. [P.L. 91-172.]

²⁸ 84 Statutes at Large 1843. [P.L. 91-614.]

²⁹ 94 Statutes at Large 2694. [P.L. 96-499.]

³⁰ 95 Statutes at Large 351. [P.L. 97-34.]

³¹ 96 Statutes at Large 568. [P.L. 97-248.]

³² 98 Statutes at Large 507. [P.L. 98-369.]

³³ 101 Statutes at Large 1330-438. [P.L. 100-203.]

³⁴ 104 Statutes at Large 1388-437. [P.L. 101-508.]

Recent Developments

Little legislative interest was shown in the communication excise tax during the 107th and 108th Congresses. However, a confluence of events has led to renewed interest in this tax during the 109th Congress. This resurgence in interest in the communications excise tax is predicated on the fact that new technologies and marketing practices have emerged in recent years. Among the technology and marketing practice changes are:

- Current law provides private communication services with exemption from the federal excise tax. Larger companies may thus be able to purchase telephone equipment that reduces both their communication costs and their federal excise tax liability.
- Technological change has blurred the lines between taxable and tax-exempt service. For example, in the case of VOIP (voice over internet protocol) voice transmissions are sent in the form of packets of information and are indistinguishable from text messages or e-mails which are tax-exempt.
- Companies now offer “bundles” of service which can include both communication services which are subject to the excise tax along with other services (i.e. cable tv, DSL, wireless internet access, and text messaging) not subject to tax.
- In some cases, newer marketing plans include the option for consumers to purchase time that is usable nationwide without long-distance charges. The Internal Revenue Code defines taxable long distance communication services as having *both* the features of time and distance. As a result, the Internal Revenue Service has lost most of those court cases in which taxpayers have requested a refund of the communications excise taxes previously paid.

In January 2005, the staff of the Joint Committee on Taxation issued a report designed to offer options to improve tax compliance and reform tax expenditures. Included were three possible options for changes to the federal excise tax imposed on communication services.³⁵ The three proposals either clarified the existing tax or extended the tax to newer communication technologies with a resultant increase in federal tax revenues. Shortly afterwards, a study on budget options by the Congressional Budget Office proposed the possible elimination of the communication excise tax.³⁶

Representative Gary Miller introduced legislation (H.R. 1898) calling for repeal of the communications tax. When introduced the legislation had 39 co-sponsors. This legislation has grown to include 100 members of the House of Representatives, some of whom sit on the House Ways and Means Committee. Senator Rick

³⁵ U.S. Congress. Joint Committee on Taxation. *Options to Improve Tax Compliance and Reform Tax Expenditures*. 109th Congress, 1st session. JCS-02-05. Washington: GPO, 2005. pp. 368-378.

³⁶ U.S. Congressional Budget Office, *Budget Options*, Feb. 2005, p. 333.

Santorum along with other members of the Senate Finance Committee have introduced companion legislation (S. 1321). At a news conference, Senator Santorum stated that “the telephone tax is regressive, inequitable, inefficient and unnecessary tax that Congressional policy makers have found to serve no rational policy purpose.”³⁷

Table 1. Brief Legislative History of the Telephone Excise Tax

Year	P.L. Number	Tax on General (Local) Telephone Service	Tax on Toll (Long Distance) Telephone Service
1898	P.L. 55-133	No Tax	1¢ if message is 15¢ or more
1902	P.L. 57-67	No Tax	Tax repealed
1914	P.L. 63-217	No Tax	1¢ if message is 15¢ or more. Effective date through 12/31/15
1915	Pub. Res., No. 2	No Tax	Extension of tax through 12/31/16
1916	P.L. 64-271	No Tax	Tax expired
1917	P.L. 65-50	No Tax	5¢ if message is 15¢ or more
1919	P.L. 65-254	No Tax	5¢ if message is over 14¢ and no more than 50¢; 10¢ if more than 50¢; 10% on leased wire or talking circuit special service
1921	P.L. 67-98	No Tax	Rates unchanged from prior law. Changes made in exemptions
1924	P.L. 68-176	No Tax	Tax repealed
1932	P.L. 154	No Tax	10¢ if message is 50¢ to 99¢; 15¢ if message is \$1.00 to \$1.99; 20¢ if message is \$2.00 or over. Tax is to terminate 7/1/34
1933	P.L. 73-67	No Tax	Extension of tax until 7/1/35
1935	Pub. Res., No. 36	No Tax	Extension of tax until 7/1/37
1937	Pub. Res., No. 48	No Tax	Extension of tax to 7/1/39

³⁷ Kurt Ritterpusch, “Finance Members Introduce Bill to Repeal Telephone Excise Tax,” Daily Tax Report, (Washington, DC) no. 124, June 29, 2005, p. G-5.

Year	P.L. Number	Tax on General (Local) Telephone Service	Tax on Toll (Long Distance) Telephone Service
1939	P.L. 76-155	No Tax	Extension of tax to 7/1/41
1940	P.L. 76-656	No Tax	Extension of tax to 7/1/45
1941	P.L. 77-250	6% (First tax on local telephone calls)	5¢ for each 50¢ or fraction thereof, if message is over 24¢
1942	P.L. 77-753	10%	20% if message is over 24¢
1944	P.L. 78-235	15% Tax to terminate 6 months after end of hostilities.	25% if message is over 24¢ Tax to terminate 6 months after end of hostilities
1947	P.L. 80-17	The tax increase provided by the 1944 legislation (P.L. 235) was to end 6 months after the termination of hostilities. This act continued the tax rates indefinitely.	
1954	P.L. 83-591	10%	10% if message is over 24¢
1958	P.L. 85-859	10%	10% — eliminates the 24¢ charge limitation
1959	P.L. 86-75	10% Tax is to terminate for bills rendered on or after July 1, 1960	10%
1960	P.L. 86-564	10% Effective date of repeal postponed until July 1, 1961	10%
1961	P.L. 87-72	10% Effective date of repeal postponed until July 1, 1962	10%
1962	P.L. 87-50	10% Effective date of repeal postponed until July 1, 1963	10%
1963	P.L. 88-52	10% Effective date of repeal postponed until July 1, 1964	10%
1964	P.L. 88-348	10% Effective date of repeal postponed until July 1, 1965	10%
1965	P.L. 89-44	Reduce to 3%, 1/1/66; Reduce to 2%, 1/1/67; Reduce to 1%, 1/1/68; Repeal, 1/1/69	Same tax rate as for general (local) telephone service

CRS-10

Year	P.L. Number	Tax on General (Local) Telephone Service	Tax on Toll (Long Distance) Telephone Service
1966	P.L. 89-368	Raise to 10%, 4/1/66; Reduce to 1%, 4/1/68; Repeal, 1/1/69	Same tax rate as for general (local) telephone service
1968	P.L. 90-285	10% Temporary extension from 3/31/68 until 4/30/68	
1968	P.L. 90-364	Extension at 10%; Reduce to 5%, 1/1/70; Reduce to 3%, 1/1/71 Reduce to 1%, 1/1/72 Repeal, 1/1/73	Same tax rate as for general (local) telephone service
1969	P.L. 91-172	Extension at 10%; Reduce to 5%, 1/1/71; Reduce to 3%, 1/1/72; Reduce to 1%, 1/1/73; Repeal, 1/1/74	Same tax rate as for general (local) telephone service
1970	P.L. 91-614	Extension at 10%; Reduce to 9%, 1/1/73; Reduce to 8%, 1/1/74; Reduce to 7%, 1/1/75; Reduce to 6%, 1/1/76; Reduce to 5%, 1/1/77; Reduce to 4%, 1/1/78; Reduce to 3%, 1/1/79; Reduce to 2%, 1/1/80; Reduce to 1%, 1/1/81; Repeal, 1/1/82	Same tax rate as for general (local) telephone service
1980	P.L. 96-499	Extension at 2%; Reduce to 1%, 1/1/82; Repeal, 1/1/83	Same tax rate as for general (local) telephone service
1981	P.L. 97-34	Extension at 1% rate for 2 additional years; Reduce to 1%, 1/1/82; Repeal, 1/1/85	Same tax rate as for general (local) telephone service
1982	P.L. 97-248	Raise to 3%, 1/1/83; Repeal, 1/1/86	Same tax rate as for general (local) telephone service
1984	P.L. 98-369	Extension at 3% rate for 2 additional years; Repeal, 1/1/88	Same tax rate as for general (local) telephone service
1987	P.L. 100-203	Extension at 3% rate for 3 additional years; Repeal, 1/1/91	Same tax rate as for general (local) telephone service
1990	P.L. 101-508	Made permanent at a 3% rate	Same tax rate as for general (local) telephone service

