Taxing Telecom: The Case for Reform

Could overtaxing mobile communications harm the telecom industry—a sector essential to boosting economic progress? An A.T. Kearney study finds a balance is needed between short-term strategies to generate revenue and long-term strategies to encourage growth.

Executive Summary

As economies still struggle in the wake of the financial crisis, some European countries believe the answer to their economic woes is increased taxation on mobile telephone use—which, according to A.T. Kearney's latest analysis of mobile sector taxation in Europe, is a short-term solution at best and a potential long-term inhibitor of economic growth.

Indeed, the European Commission identifies telecommunications as a driver of economic progress. Countries that increase taxes and regulatory fees on this industry—as they have with tobacco and alcohol—not only discourage use of these products but also restrict investment and threaten growth in GDP, productivity, and jobs. This is as true for telecoms as it is for adjacent sectors such as banking and energy, where growth and innovation rank high on strategic agendas.

Telecom operators in Europe already contribute significant tax revenue to European governments—on average, 24 percent of the average price per minute (APPM). These contributions include the value-added tax (VAT), social security tax, corporate tax, regulatory fees, and telecom sector-specific taxes.

Despite Europe's fiscal crisis and the understandable search for more sources of funding, most countries have resisted sector-specific taxation on the mobile industry. To date, just five European countries—Hungary, Greece, Spain, France, and Slovakia—have levied more taxes on the mobile industry. These five countries, focused on meeting their short-term funding challenges, are likely to face longer-term consequences.

Our findings suggest that while the telecom industry should pay appropriate taxation and regulatory fees, a balance is needed between short-term revenue schemes and long-term strategies to support industry innovation and growth. As noted in the GSMA's 2013 report on the mobile economy, the telecom industry should be subject to taxation and regulatory fees only to the same extent as other commercial enterprises.[1]

Understanding the Economic Impact

Telecommunications drives economic progress, according to the European Commission, which identifies telecommunications as a key economic driver. Yet as economies stall, some countries believe the answer to their financial woes is more taxes on the mobile telephone industry. This is a short-term solution at best. And down the road, such a move could be a stumbling block for economic growth. After all, the European mobile telecom industry is struggling already with regulatory compliance and challenging growth prospects.

To gain a better understanding of the impact of government taxes and fees on the telecom industry, A.T. Kearney performed a study across the EU27 countries, and Switzerland, Norway, and Serbia (see sidebar: About the Study on page 4). In an analysis of average price per minute (APPM), the results vary from 12 to 40 percent; however, on average, 24 percent of APPM is the result of government-imposed taxes and fees.

[1] GSMA Mobile Economy 2013, Section 6.5, The Importance of Best PracticeTaxation

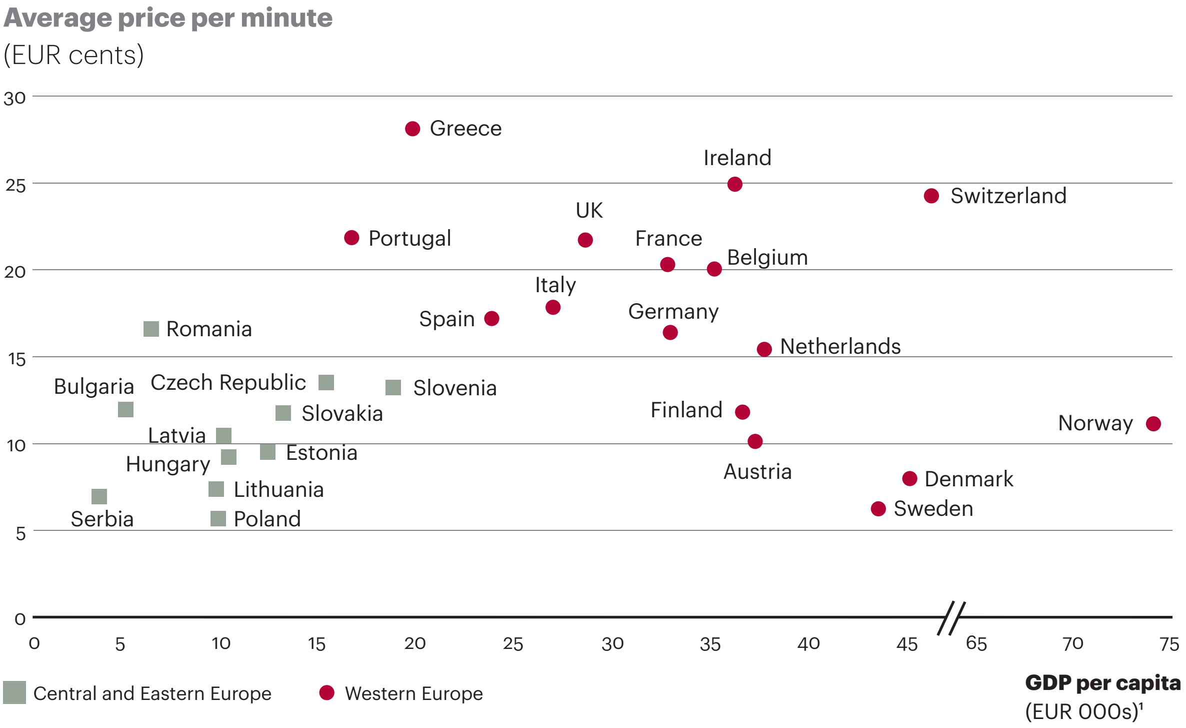
It is difficult for operators to pass on tax increases to end consumers who often compare prices for products and services on a regional basis.

When analyzing GDP growth and mobile APPM, Western European countries have a broader spread, while Eastern European countries are more clustered (see figure 1). Although a direct correlation is difficult to establish—because APPM is also dependent on local competition and country-level prices—Western Europe's average APPM is 55 percent higher than Eastern Europe's.

The countries paying the highest APPM for mobile telephony are Greece, Ireland, and Switzerland; the lowest prices are in Serbia, Sweden, and Poland (see figure 2 on page 4). Greece's APPM is driven by a high share of prepaid tariffs, and Switzerland's is driven by overall high prices on telecommunications. In low-price countries competition is high, and in Sweden all-inclusive bundles are pushing prices even lower.

What is less apparent, but highlighted in our analysis, is that 12 to 26 percent of APPM is directly driven by local tax regimes such as the value-added (VAT), social security and contributions,

Figure 1
Comparison of APPM and GDP by country

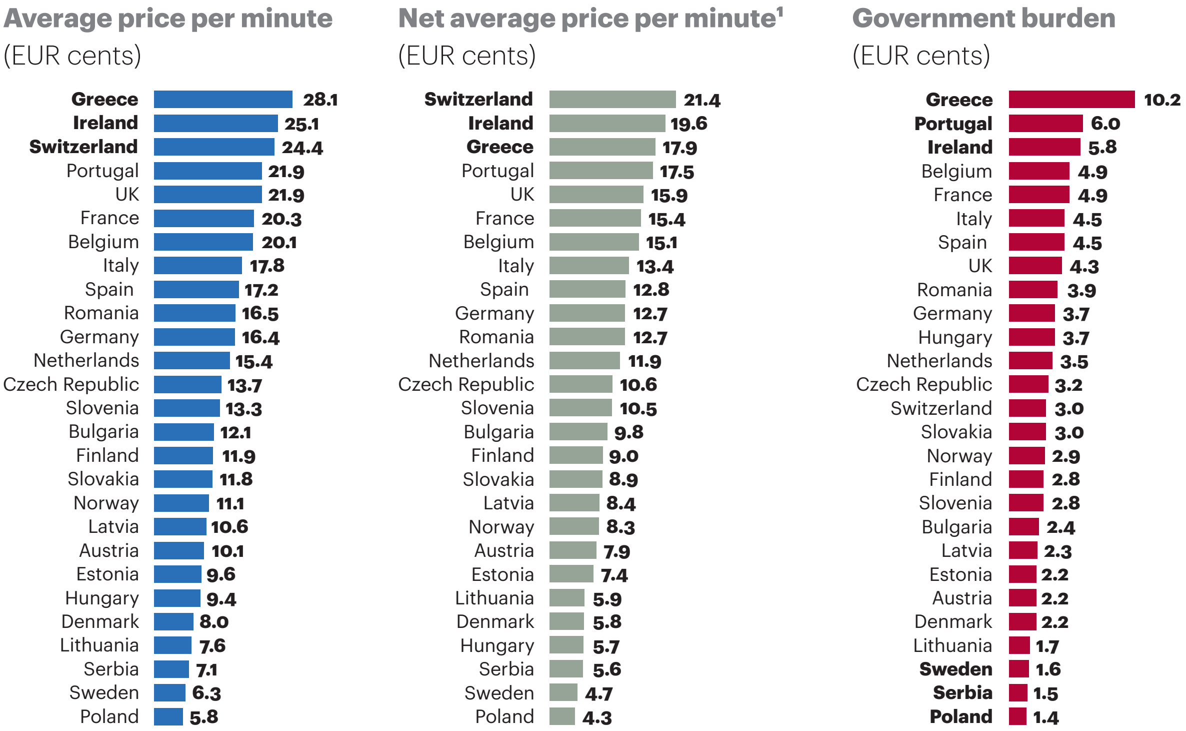


[1] Nominal GDP per capita as defined by the International Monetary Fund in 2011

Sources: Review of telecom prices 2013, local authorities, International Monetary Fund 2011; A.T. Kearney analysis

Figure 2

Telecoms in Greece, Ireland, and Switzerland have the highest price per minute



[1] Net average price per minute excludes value-added tax, social tax, corporate tax, regulator financing fees, sector-specific taxes, number fees, and spectrum fees.

Source: Review of telecom prices 2013; A.T. Kearney analysis

About the Study

In early 2013, A.T. Kearney conducted a study of the average price per minute (APPM) and the breadth of taxes and fees mobile operators incurred by year end 2012. The scope was the EU27 countries, along with Switzerland, Serbia, and Norway. Cyprus, Malta, and Luxembourg were excluded because of the small size of each market.

APPM data was collected and analyzed by Tariff Consultancy Ltd. on a country-average level, based on minutes-of-use volume. APPM data was used to capture the precise end user price per minute of mobile telephone use and to ensure accurate cross-country comparisons by applying a customer distribution to a set of price plans (high, medium, and low) by country. The customer distribution and usage pattern is derived from separate studies performed with operators across European countries.

Secondary research was collected from the European Commission, studies by large global auditing firms on general taxation (including VAT, social security and contributions, and corporate), and A.T. Kearney's Global Competitive Benchmarking study.[2] Primary research was collected on regulator financing fees, annual spectrum fees, and other sector-specific taxes in interviews with local regulators.

The study was performed in euros without purchasing power parity adjustments to reflect actual APPM by country.

The study focus is on recurring taxes and regulatory fees that affect today's telecommunications pricing. To this extent only are annual spectrum fees and annual number series fees paid to the regulator included. While in some countries annual spectrum acquisition costs will add additional governmental contributions, for the purposes of this study, such costs are viewed as non-recurring, one-time capital investments similar to expanding network capacity and therefore are not included.

[2] Information about A.T. Kearney's Global Competitive Benchmarking study is available at www.atkearney.com.

and corporate taxes (excluding taxes on salaries paid by employees). VAT is by far the largest component, but it mostly applies equally across products and services within countries. On the other hand, the corporate tax level is a differentiator, which explains some variations in APPM among countries. Notably, social tax contributions (welfare and pensions) alone do not add a major burden because of operators' low dependency on direct salaries. The impact of these general taxes on APPM ranges from 1.3 cents (Poland) to 6.8 cents (Greece). On a relative scale, the impact is lowest in Switzerland (12 percent) and highest in Portugal (26 percent).

Fourteen of the 30 countries in the study levy regulatory financing fees that affect net APPM. Only a few levy special telecom-sector taxes, further penalizing the price per minute (see sidebar: Five Countries Hitting Hard with Telecom Taxes on page 7). In the vast majority of the countries studied, the special taxes and fees on the telecom sector are negligible to APPM, except in Greece and Hungary where the special taxes have an approximate impact of 12 percent of APPM, 3.43 cents and 1.09 cents respectively. In Spain, with the third largest impact, the special taxes only correspond to .34 cents or 2 percent of APPM.

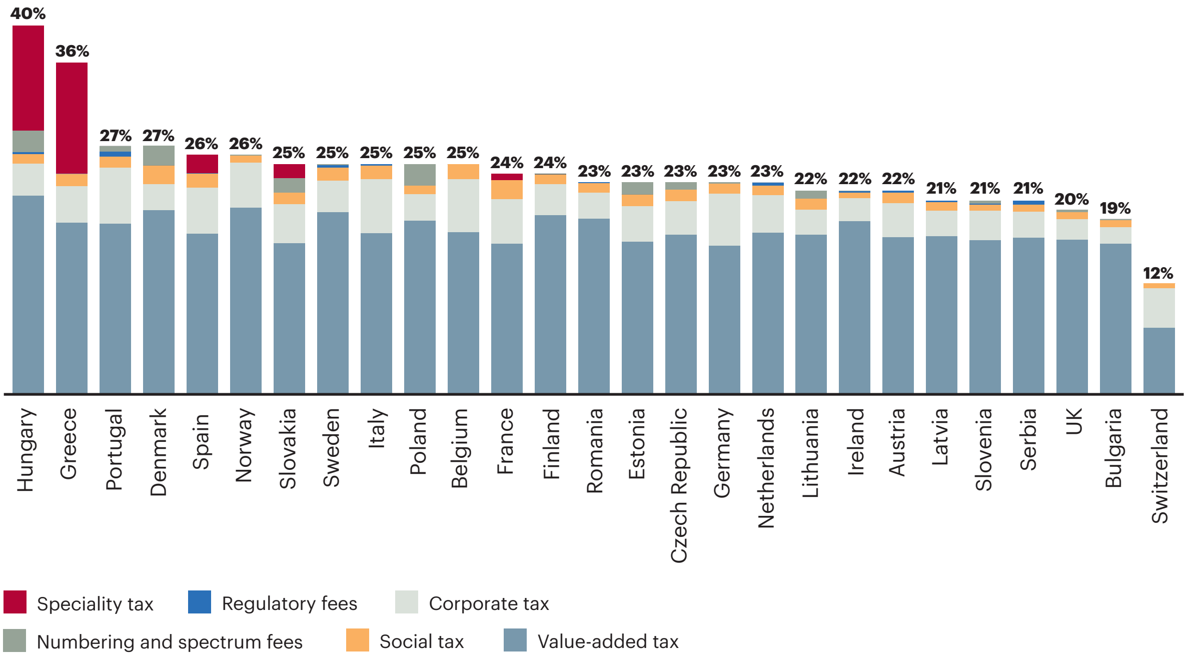
In countries with annual recurring spectrum and numbering fees, Poland, Hungary, and Denmark are prominent, with impacts of more than 2 percent on APPM. When comparing the total compounded government burden on APPM, two countries stand out: Hungary with a total burden of 40 percent (expected at about 35 percent for 2013) and Greece with 36 percent (see figure 3). Both countries were dealt a heavy blow by the financial turmoil that began in late 2008.

Figure 3

Greece and Hungary stand out in the total compounded government tax burden on average price per minute

Total governmental burden[1]

(% of average price per minute)



[1] Includes general taxes (value-added tax, corporate tax, and social tax), regulator fees, sector specific taxes, and annual spectrum and numbering fees

Sources: Review of telecom prices 2013, local authorities, International Data Corporation; A.T. Kearney analysis

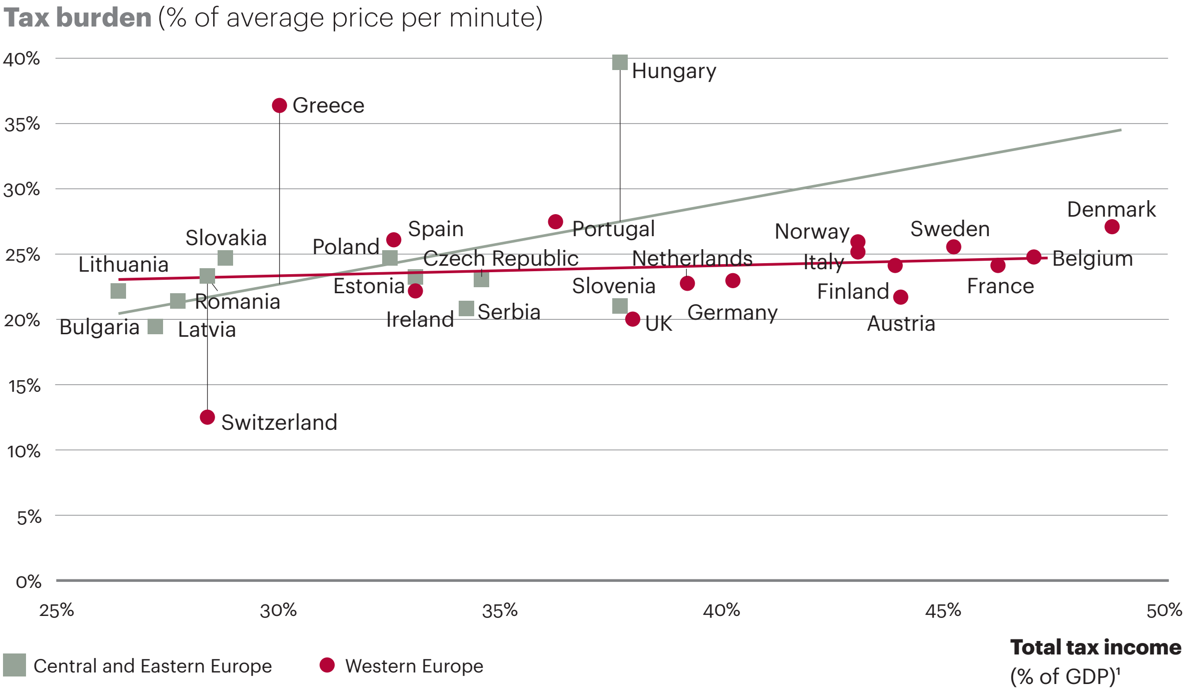
Greece revised its postpaid tax in 2009 to also address prepaid usage, and Hungary introduced the telecom sector tax in 2010. In our analysis of the total government burden versus the total national tax income as a share of GDP, Greece and Hungary do not follow the pattern of other European countries (see figure 4).

On average, **24 percent of the average price per minute (APPM) is the result of government-imposed fees.**

As a counter-reflection on operators' total contribution to government funding, we note that in March 2013 the Czech Telecommunication Office (ČTÚ), the country's independent telecommunications regulatory authority, suspended ongoing spectrum auctions because bids had risen too high and could lead to significant price increases for consumers. As explained by ČTÚ Chairman Pavel Dvorak in a press release: "Before publication of the conditions in the first half of last year, we pointed out that the main motivation for organizing the auction was to provide quick availability of 4G networks for Czech citizens and a possible fourth entry operator; it was not to profit the state. Moreover, such high prices for the frequencies auctioned would have resulted in exorbitant rates for high-speed mobile Internet. We therefore considered it necessary to intervene and prevent future negative consequences for consumers."

Figure 4

Greece and Hungary do not follow the pattern of other European countries



[1] Total governmental tax income as a percent of GDP as defined by Eurostat in 2011

Sources: Review of telecom prices 2013, local authorities, Eurostat; A.T. Kearney analysis

Operators Under Pressure to Generate Value

European mobile operators face significant challenges in terms of growth and delivering sustained returns, with pressure building on four fronts:

Traditional competitors. With new entrants, virtual operators, and multiple networks in one country, traditional competition has increased. Markets are characterized by cut-throat price competition across mobile network operators (MNOs) and mobile virtual network operators (MVNOs) and increasing pressure on capex investments in networks to deliver high-quality data services despite many countries' falling average revenue per user (ARPU).

New competitors. Over-the-top (OTT) players have quickly become a new competitive force and are threatening core voice and SMS volumes while at the same time putting more pressure on network owners to invest in added capacity to meet customers' evolving needs.

Owner requirements for returns. Operators must match their market investments with owners' requirements for cash flow and returns.

EU, government, and regulatory burdens. Operators must adhere to EU, government, and regulatory tax burdens.

Five Countries Hitting Hard with Telecom Taxes

For most European countries, special taxes that target the telecom sector have a negligible effect on average price per minute (APPM). However, five countries are hitting harder:

Hungary introduced a telecommunications tax in 2010 that is 6.5 percent of revenue. In July 2012, a per-minute usage tax was added. This tax will replace the 6.5 percent tax in 2013, but the cap level for users will increase. Hungary's tax is being challenged by the European Commission, where proceedings are ongoing in the European Court of Justice (ECJ) despite a mid-2012 structural change that reduced the total tax burden for 2013. Among European countries, Hungary has the second highest governmental burden as a percent of APPM. The impact on APPM: 11.5 percent.

Greece introduced a specific tax on post-paid subscriptions in 1998. The tax, which was updated in 2009 to also include prepaid phones, varies between 12 and 20 percent depending on consumption and the type of subscription. The impact on APPM: 12.2 percent.

Spain introduced a tax in 2009 that consists of a 0.9 percent tax on revenue to fund public television and 1.5 percent of revenue to fund local municipalities. In 2011, the European Commission referred Spain to the ECJ for telecom taxes. The court process is still ongoing. The impact on APPM: 2.1 percent.

France introduced a tax in 2009 as a way to fund public television. The tax is 0.9 percent of revenue. In 2011, the European Commission referred France to the ECJ for telecom taxes. The court process is still ongoing. The impact on APPM: 0.8 percent.

Slovakia is the latest country to add a sector-specific tax, targeting regulated industries with significant foreign ownership. However, that tax will only be in place for 2012 and 2013. In 2012, Slovakia introduced a tax for utilities companies, including telecom operators, of 4.2 percent of annual profit. The new tax on regulated industries is one of several measures proposed to reduce public deficit below 3 percent of GDP. The tax targets industries with high foreign investments. The utilities profit tax is expected to be removed by the end of 2013, but the corporate tax level will also be increased from 19 to 23 percent in 2013. The impact on APPM: 1.6 percent, with an additional 0.8 percent in 2013 from the higher corporate tax.

In 2010, Serbia introduced a telecom tax that was 10 percent of operator revenues. The tax has since been repealed.

Revenue growth in the telecom industry is challenging enough. An added burden of sector-specific taxes not only hampers operators' growth opportunities but also economic development in countries with such taxes. Our latest report for the European Telecommunications Network Operators Association (ETNO) concludes that an improved and harmonized tax regime is an important element of a policy framework that supports growth and is a move toward a single EU telecommunications market.[3] Regulators and governments would be wise to review the total burden on the telecom sector to drive 4G penetration and foreign direct investment (FDI) to fuel growth—as connectivity increasingly becomes a key differentiator for foreign investments.

So What Does This Imply?

The telecom industry is an important contributor to government funding across all the European countries included in our study. The industry's financial contributions range from the VAT to large commitments in spectrum auctions and specific taxes on usage. Sector-specific or usage-driven taxes are easy to implement and a quick way to collect revenue.

Countries that increase taxes and regulatory fees on the telecom industry not only **restrict investment but also threaten growth in GDP, productivity, and jobs.**

Governments may conjecture that their policies will reduce profits only for foreign-owned companies, but economic theory—and our empirical analysis—suggests the tax burden is passed on to consumers. Indeed, usage taxes are typically imposed to constrain certain practices while also raising revenue to offset negative consequences. For example, taxes on tobacco and alcohol are designed to deter use and ensure that smokers and drinkers pay for higher healthcare costs; a carbon dioxide tax is imposed to discourage use of petrol and promote low-carbon energy sources.

There are two problems with using this taxation model on the telecom sector:

- Making a call or accessing a website from a smartphone is not an undesirable behavior and should not be grouped with other sector- or usage-specific tax products, such as alcohol, tobacco, and petrol.
- It is difficult for operators to pass on tax increases to end consumers who often compare prices for products and services on a regional basis. This means telecom operators may have to absorb part of the government burden, as we found no evidence of price increases corresponding to special taxes levied.

[3] See "A Future Policy Framework for Growth," May 2013, at www.atkearney.com.

Although we found no evidence that high government taxes correlate with lower GDP or general national taxation levels, countries with telecom sector-specific taxes tend to have larger financial and funding issues.

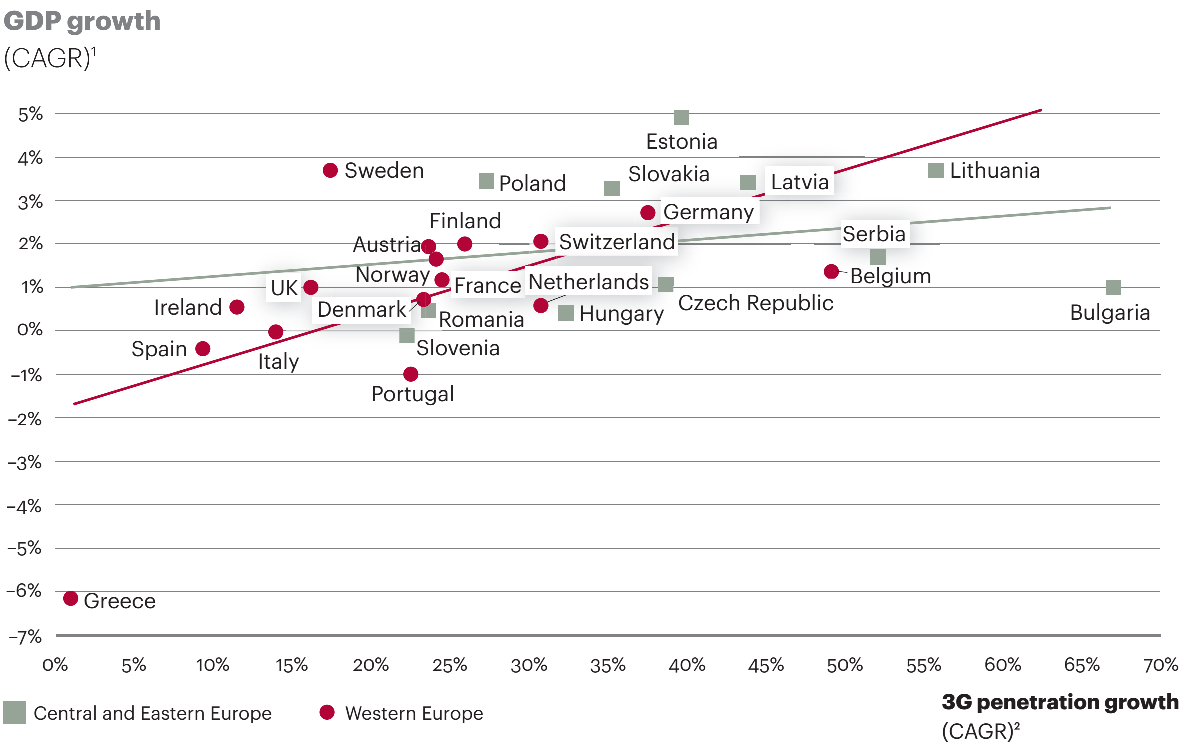
Our study also finds that 3G penetration supports GDP growth across Western and Eastern Europe (see figure 5). This is substantiated by findings in a 2012 GSMA study. However, when taxes increase, 3G penetration growth rates decrease along with GDP (see figure 6 on page 10).

Finding the Right Balance

Addressing short-term funding challenges with sector-specific taxes can put a heavy burden on the telecom industry. Considering how these taxes can affect the maturity of telecommunications standards, the penetration of 3G and LTE networks, and GDP and FDI growth, this short-term fix can cause long-term problems. Balancing the government burden on telecom operators can stimulate growth and development of 4G networks for high-capacity data access—which, in turn, can unlock long-term economic advantage across Europe.

Figure 5

Countries with greater 3G penetration tend to have stronger GDP growth



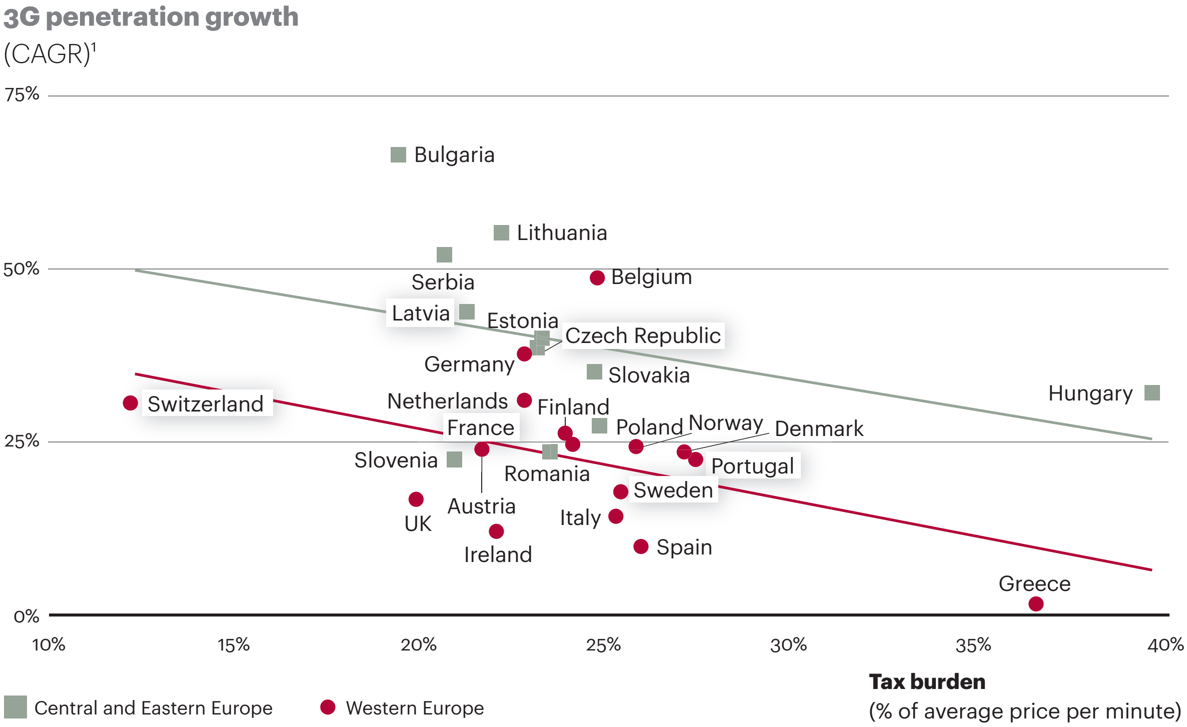
[1] Real GDP growth as defined by Eurostat

[2] 3G penetration growth as a percent of population when comparing the fourth quarters of 2009 and 2012

Sources: Eurostat 2013, Wireless Intelligence 2013; A.T. Kearney analysis

Figure 6

3G penetration growth is slower in countries with a higher tax burden



[1] 3G penetration growth as a percent of population when comparing the fourth quarters of 2009 and 2012

Sources: Eurostat 2013, Wireless Intelligence 2013; A.T. Kearney analysis

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