HB 1492

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 1492 (Delegate Hixson, *et al.*)
Ways and Means

Communications Tax Reform Act of 2014

This bill alters the current State taxation of communications services by (1) repealing the public service company franchise tax currently imposed on persons engaged in a telephone business; (2) repealing the 6% sales and use tax imposed on certain telecommunications services; (3) imposing a 4% sales and use tax on the sale of "communications services"; and (4) repealing the boxing and wrestling tax on specified telecasts. The bill also directs 7.5% of sales and use tax revenue from communications services to the Rural Broadband Assistance Fund (RBAF) in fiscal 2015 through 2020.

The bill takes effect July 1, 2014. The distribution to the Rural Broadband Assistance Fund terminates upon termination of Chapter 269 of 2006.

Fiscal Summary

State Effect: General fund revenues increase by $4.8 million in FY 2015 and by $4.0 million in FY 2019. Special fund revenues increase by $20.7 million in FY 2015 and by $23.0 million in FY 2019. Expenditures increase by approximately $277,600 in FY 2015, which includes one-time computer programming expenditures. Future year estimates reflect annualization and inflation.

($ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF Revenue	$4.8	$4.6	$4.4	$4.2	$4.0
SF Revenue	$20.7	$21.3	$21.8	$22.4	$23.0
GF Expenditure	$.3	$.1	$.1	$.1	$.1
Net Effect	$25.3	$25.9	$26.2	$26.6	$26.9

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill defines "communications service" as a (1) local exchange or interexchange telephone service that is subject to regulation by the Public Service Commission; (2) cellular telephone service or other mobile telecommunications service; (3) "900," "976," "915," and other "900"-type telecommunications service; (4) custom calling service provided in connection with basic telephone service; (5) telephone answering service; (6) prepaid telephone calling arrangements; (7) voice over Internet protocol service, as defined in § 8-601 of the Public Utilities Article; (8) pay-per-view television service; (9) cable television service; (10) satellite television service; (11) satellite radio service; (12) equipment rented or sold by a cable television provider or satellite television provider to a subscriber that is necessary to receive television service, including a cable box or a satellite dish; or (13) audio or audiovisual content streamed through the Internet, including television, motion pictures, or radio.

A "communications service provider" is a person principally engaged in the business of distributing, transmitting, monitoring, switching, routing, or producing a taxable communications service. The sales and use tax does not apply to a sale of tangible personal property to a communications service provider if the property is (1) used directly and predominantly in the distribution, transmission, monitoring, switching, routing, or production of a taxable communications service or (2) integral or necessary for the installation, operation, or maintenance of specified communications property.

Current Law: The State's 6% sales and use tax is imposed on several telecommunications-related services including cellular phone and other mobile telecommunications services, telephone custom calling features, 900-type telephone services, telephone answering services, and prepaid telephone calling arrangements.

In addition, a public service company franchise tax of 2% is imposed on the gross receipts of telephone, electric, and gas companies. Gross receipts are defined as the total operating revenues of the public service company, excluding revenue derived from an activity other than a telephone, electric, or natural gas business. Gross receipts do not include uncollectible revenue, receipts from a service or product resold by another public service company that is subject to the tax, or gross receipts from the sale of electricity or natural gas. For electric and gas companies, a second tax is imposed measured by the kilowatt hours of electricity or therms of natural gas delivered for final consumption in the State.

The boxing and wrestling tax rate is 10% of the gross receipts for charges to view a telecast of a boxing or wrestling contest. For charges for admission to a boxing or wrestling contest, the rate is the greater of 10% of the gross receipts or $200. For charges for admission to a boxing or wrestling contest, the rate is 5% of the gross receipts if the contest is conducted by the Maryland National Guard; or, in Allegany County, a post of the Veterans of Foreign Wars or the American Legion. For charges to view a telecast of a boxing or wrestling contest, if gross receipts subject to the boxing and wrestling tax are also subject to the sales and use tax, the boxing and wrestling tax rate must be set so the total tax rate does not exceed 10% of the gross receipts.

Currently, most counties and Baltimore City impose one or more local sales and service taxes. Counties, municipalities, and special taxing districts are generally limited to imposing sales and use taxes on fuels, utilities, space rentals, and in code counties only and to a limited extent, on food and beverages in a resort area. For example, Worcester County, a code county, imposes a 0.5% food and beverage tax within Ocean City. These taxes are authorized under State law. The authorizations in some cases allow for exemptions to be granted by the counties, restrict the use of the revenue collected, set a limit on the tax rate, or require certain procedures such as a public hearing before imposing a tax.

Chapter 269 of 2006 established the Rural Broadband Assistance Fund (RBAF) as a nonlapsing special fund in the Department of Business and Economic Development (DBED). The RBAF is to be used only for planning, construction, and maintenance of broadband services and infrastructure in rural and underserved areas.

Background:

Communications Tax Reform Commission

Chapters 261 and 262 of 2012 established the Communications Tax Reform Commission. The commission was required to assess the feasibility and fiscal implications for the State and local governments of a modernized, competitively neutral communications tax and fee system that eliminates the disparate treatment of similar communications service providers. In addition, the commission was required to assess the efficacy of tax and other incentives to encourage investment in broadband networks and emerging technologies.

In conducting the assessment, the commission was required to examine the following taxes and fees as they relate to consumers and providers of communications services: (1) State and local property taxes; (2) the public service company franchise tax; (3) sales and use taxes; (4) the corporate income tax; (5) local communications taxes and fees; and

(6) any other communications tax or fee that the commission determines is relevant to the assessment.

The Comptroller and the State Department of Assessments and Taxation (SDAT) were required to collect data from the State and local governments to determine the amount of revenue collected by the State and local governments from all relevant taxes and fees on communications services during fiscal 2012. They were also required to collect data from communications service providers to determine the amount of revenue remitted to the State and local governments by each communications service provider in relevant taxes and fees on communications services during fiscal 2012.

The commission met during 2012 and the first half of 2013 and issued a final report of its findings to the Governor and the General Assembly on June 30, 2013. The commission report offered no recommendations, but did examine three proposals for communications tax reform. In addition, the report stated various findings including:

- the identification of the taxes and fees levied on communications services in Maryland;
- the quantification of communications revenue received by the State and local governments in fiscal 2012;
- the estimated revenue implications of implementing certain reform proposals;
- the difficulties implicit in building-out broadband capacity in rural areas;
- that a multitude of opinions on the benefits of, and optimal course for, reform existed among commission members; and
- the identification of obstacles that complicated the prediction of communications revenues under any tax and fee structure.

Previous Examinations of Communications Tax Reform

Telecommunications tax reform in Maryland has been proposed several times in the last 25 years. In 1990, the Linowes Commission recommended the repeal of the gross receipts tax for telephone companies. At that time, the telephone companies were not subject to the corporate income tax and the repeal of the gross receipts tax would have automatically resulted in the imposition of the corporate income tax on those companies. In addition to the repeal of the gross receipts tax, the Linowes Commission recommended that the sales tax be imposed on all nonresidential telecommunications services, coupled with a sales tax exemption for the telephone companies' purchase of equipment.

The Linowes Commission recommendations regarding telephone taxes were not adopted, but legislation was enacted in 1992 to impose the corporate income tax on the income of long distance telephone companies. Long distance telephone companies, as well as the local telephone company, remained subject to the PSC franchise tax. The 1992 legislation for the first time authorized the long distance companies, but not the local telephone company, to show the gross receipts tax as a separate line item on customers' bills. That legislation also extended the sales and use tax to a number of telecommunications services, including custom calling services, 900-type telephone service, and telephone answering services, as well as pay-per-view television service.

In the mid-1990s telecommunications tax reform was again proposed. In 1995, Senate Bill 632 would have repealed the gross receipts tax and imposed the sales tax broadly on telephone service, providing an exemption for the first $14 per month of basic local residential telephone service. In 1997, telecommunications tax reform was again considered, with Chapters 629 and 630 enacted to impose the corporate income tax on the local telephone company; to specifically exempt from the gross receipts tax revenues from Internet access service; to provide telephone companies a credit against the corporate income tax to reimburse them for the additional property tax resulting from the assessment of operating real property at 100% of value (as opposed to assessment at 40% of value for real property of ordinary taxpayers); and to authorize the local telephone company to show the gross receipts tax as a separate line item on customers' bills.

During the 2001 session, further telecommunications tax reform was proposed in HB 768/SB 787. The 2001 bills would have repealed the gross receipts tax on telephone companies and imposed the sales and use tax broadly on telephone service, with exemptions for toll-free 800-type service and "private line" phone networks. The bills also would have provided a sales tax exemption for the sale of machinery and equipment to a telecommunications provider for use in the conduct of a telecommunications business, an Internet service business, or a web-hosting business.

State Revenues: Total State revenues increase by $276.6 million in fiscal 2015 and by $306.5 million in fiscal 2019. However, because the bill reduces the current 6% sales tax rate to a 4% rate on several communications services that are currently taxed and also exempts certain equipment purchases by communications companies, total net revenues are estimated to increase by $25.6 million in fiscal 2015 and by $27.0 million in fiscal 2019. In addition, because the bill directs 7.5% of total communications service revenues to RBAF for fiscal 2015 through 2020, general fund revenues will increase by $4.8 million and RBAF revenues will increase by $20.7 million in fiscal 2015. The impacts on State revenues of each of the bill's major provisions are shown in **Appendix 1**. The estimate is based on survey data of over 300 businesses and each local government that collects a communications related tax as analyzed by the Comptroller's Office and SDAT for the Communications Tax Reform Commission.

In fiscal 2012, it is estimated that telephone companies paid approximately $34.3 million in franchise taxes. While communications services in general have grown at a rapid rate recently, revenues from land lines (and corresponding tax revenues) have declined due to price competition in long distance service and competition in local service from wireless communications service providers. Due to these factors, the revenue loss from the elimination of the franchise tax is estimated at $35.4 million in fiscal 2015.

Replacing the 2% franchise tax with a 4% State sales tax on communications services will increase the revenue base (before adjustments) by 200%. Certain revenues collected under the franchise tax, however, would not be collected under a sales and use tax. The franchise tax is based on gross receipts and includes revenues received by the phone companies for telecommunications provided to the federal government, the State, local governments, and charitable nonprofit organizations. None of these purchasers, however, would be subject to the sales and use tax. Imposing a 4% sales and use tax on landline telephone service is estimated to increase revenues by approximately $64.9 million in fiscal 2015. The net effect of these provisions is a $29.5 million increase in fiscal 2015.

The bill reduces the sales tax on cellular service from 6% to 4%. This is estimated to result in a net decrease in revenues of $48.4 million in fiscal 2015. As noted, the sales and use tax currently applies to several communications related services. The bill repeals the current 6% sales tax rate on these services and instead imposes a 4% sales tax rate. The net effect on revenues of this provision is a revenue reduction of $3.1 million in fiscal 2015. In addition, the bill exempts certain equipment purchases made by communications companies and repeals the 10% sales tax imposed on boxing and wrestling pay-per-view telecasts and imposes a 4% sales tax instead. The net effect of these provisions is a revenue decrease of $36.3 million in fiscal 2015.

To offset some of the revenue losses associated with reducing the sales and use tax rate from 6% to 4% on certain services, the bill also imposes a 4% sales tax on cable television, satellite television, and certain Internet streaming services, which are not currently subject to the State sales and use tax. Based on data collected for the Communications Tax Reform Commission, it is estimated that sales taxes on cable and satellite television and Internet streaming services will be approximately $92.0 million in fiscal 2015.

State Expenditures: In order to implement the provisions of the bill, general fund expenditures for the Comptroller's Office increase by $277,636 in fiscal 2015, which accounts for a 90-day start-up delay due to the bill's July 1, 2014 effective date. This estimate reflects the cost of hiring one field auditor to verify compliance with applicable standards for taxation. It includes salaries, fringe benefits, one-time start-up costs, ongoing operating expenses, and one-time computer programming and modification costs to add a line to the sales and use tax return to allow for the remittance of the new 4% sales tax rate as well as testing by certain vendors.

Position	1
Salary and Fringe Benefits	$49,231
Programming Expenses	223,600
Operating Expenses	4,805
Total FY 2015 State Expenditures	**$277,636**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Montgomery County, State Department of Assessments and Taxation, Comptroller's Office, Department of Business and Economic Development, Public Service Commission, Maryland Department of Transportation, Department of Legislative Services

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mc/jrb

Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Appendix 1
Effect of Legislation on State Revenues
($ in Millions)

Bill Provisions	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Public Service Company Franchise Tax @2%	(35.4)	(35.8)	(36.2)	(36.6)	(37.0)
Sales tax on landline service @ 4%	64.9	65.6	66.3	67.0	67.8
Sales tax on wireless @ 6%	(145.1)	(149.5)	(153.9)	(158.6)	(163.3)
Sales tax on wireless @ 4%	96.7	99.6	102.6	105.7	108.9
Taxable telecom services @6%	(9.3)	(9.6)	(9.9)	(10.2)	(10.5)
Taxable telecom services @ 4%	6.2	6.4	6.6	6.8	7.0
Capital Equipment @ 6%	(35.3)	(36.4)	(37.5)	(38.6)	(39.8)
Pay-per-view boxing and wrestling @ 10%	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)
Pay-per-view boxing and wrestling @ 4%	0.7	0.7	0.7	0.7	0.7
Pay-per-View @ 6%	(12.3)	(12.7)	(13.1)	(13.5)	(13.9)
Pay-per-View @ 4%	8.2	8.5	8.7	9.0	9.2
Communications Equipment rented or sold @ 6%	(11.9)	(12.2)	(12.6)	(13.0)	(13.4)
Communications Equipment rented or sold @ 4%	7.9	8.2	8.4	8.7	8.9
Cable TV @4%	67.1	69.1	71.2	73.4	75.6
Satellite TV @4%	19.4	20.0	20.6	21.2	21.8
Various Internet Streaming @4%	5.5	5.8	6.0	6.3	6.7
Total New Collections	**276.6**	**283.8**	**291.1**	**298.7**	**306.5**
Net Collections (new minus current)	**25.6**	**25.9**	**26.3**	**26.6**	**27.0**
RBAF @ 7.5%	**20.7**	**21.3**	**21.8**	**22.4**	**23.0**
General Fund	**4.8**	**4.6**	**4.4**	**4.2**	**4.0**

Source: Report of the Communications Tax Reform Commission; Department of Legislative Services