Department of Fiscal Services
Maryland General Assembly

FISCAL NOTE
Revised

House Bill 512 (Delegate Howard, *et al.*)
Ways and Means — Referred to Budget and Taxation

Telecommunications Tax Reform

This enrolled bill subjects all revenues derived from telephone business to the corporate income tax and creates a credit against the corporate income tax for certain property taxes paid by public utilities. Cables, lines, poles, and towers of telecommunications companies are reclassified as operating personal property. The bill also exempts from the public service company franchise tax (gross receipts tax) revenues from sales of Internet access service.

The Comptroller of the Treasury and the Department of Assessments and Taxation shall report on the corporate income tax revenues from and credits claimed by telecommunications companies attributable to this Act. This report shall be presented to the House Committee on Ways and Means and the Senate Budget and Taxation Committee by November 15, 1999.

This bill is effective July 1, 1997. Changes to the income tax are effective for tax years beginning after December 31, 1997; the income tax credit is allowed only for property tax paid for a property tax year beginning after July 1, 1998.

Fiscal Summary

State Effect: General fund revenues could increase $11.8 million in FY 1999; special fund revenues could increase by a net $1.3 million. Expenditures would not be affected. Out-year changes reflect full implementation of the bill.

(in millions)	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
GF Revenues	$0.0	$11.8	$10.3	$10.8	$11.3
SF Revenues	0.0	1.3	0.7	0.7	0.7
GF Expenditures	0.0	0.0	0.0	0.0	0.0
Net Effect	$0.0	$13.1	$11.0	$11.5	$12.0

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

Local Effect: Local revenues could decline an indeterminate but minimal amount, and increase an estimated $1.0 million in FY 1999 from increased distributions from the

Transportation Trust Fund (TTF). This increase is incorporated into the above estimates.

Small Business Effect: Minimal effect on small businesses, as discussed below.

Fiscal Analysis

Bill Summary: This bill subjects all revenues derived from telephone business to the corporate income tax. It also creates a credit against the corporate income tax in an amount equal to 60% of the total property taxes paid by a public utility on operating real property used in its telecommunications business other than operating land. This credit is not refundable, must be applied after the application of any other credits, and may not be carried over to any other taxable year. The full amount of the credit must be added to income as an addition modification for income tax purposes. Cables, lines, poles, and towers are reclassified as operating personal property. The bill also provides that revenues from the sale of Internet access service are exempt from the gross receipts tax.

All telecommunications companies are required to disclose the gross receipts tax as a line item on the telephone bill. The Public Service Commission (PSC) is required to reduce telephone rates to reflect the removal of the gross receipts tax from the rate base. Local telephone service providers are required to inform customers that the gross receipts tax line item is not a tax increase but a disclosure of taxes previously paid by the customer. This notice is required with the first monthly billing for which the tax is shown as a line item, and for three months thereafter.

State Revenues: General fund revenues could increase an estimated $11.8 million in fiscal 1999. Transportation Trust Fund revenues could increase an estimated $3.9 million in fiscal 1999, and annuity bond fund revenues could decline by an estimated $2.6 million, as discussed below (**Exhibit 1** shows the revenue effect in detail).

Exhibit 1

Fiscal Impact of House Bill 512

($ in millions)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Corporate Income Tax (net)	0.000	15.679	13.715	14.401	15.121
State Property Tax	0.000	(2.638)	(2.770)	(2.908)	(3.054)
Net Effect	0.000	13.041	10.945	11.493	12.067
General Fund	0.000	11.759	10.286	10.801	11.341
TTF	0.000	3.920	3.429	3.600	3.780
Annuity Bond Fund	0.000	(2.638)	(2.770)	(2.908)	(3.054)

Corporate Income Tax

For State income tax purposes, local exchange carriers are currently allowed to subtract from federal taxable income the gross receipts which are subject to the public service company franchise tax. This bill subjects gross receipts on which the franchise tax has been paid to the income tax as well. In 1995, telecommunications companies subtracted $333 million of income under this provision. This amount has grown by approximately 9% per year. An estimated $431 million of subtractions would be disallowed in 1998, resulting in an increase in corporate income tax revenues of $30 million. This amount is expected to increase by 5% in the out-years, slower than the historical average, due to increasing competition.

The bill also grants telecommunications companies a credit against the corporate income tax in the amount of 60% of the State, county, and municipal property taxes paid on operating real property used in their telecommunications business. Property taxes paid by telecommunications companies are estimated at $30.9 million for tax year 1999 and are expected to increase by 5% per year. The credit therefore amounts to $18.5 million, for a net increase of corporate income tax revenues of $11.6 million attributable to 1998. It is estimated that 95% of this revenue will be received in fiscal 1999, and 5% in fiscal 2000; for tax year 1999 and later, 25% of the increase will be received in the first fiscal year, 70% in the second, and 5% in the third. Thus, corporate income tax revenues would increase by $13.9 million in fiscal 1999 and $12.2 million in fiscal 2000, increasing by 5% per year thereafter. About 75% of this increase would accrue to the general fund, and 25% to the TTF. Therefore, general fund revenues would increase by $10.4 million in fiscal 1999, and

TTF revenue would increase by $3.5 million (a portion of this increase would be distributed to local governments).

The addition modification for the amount of the property tax credit could increase taxable income by $18.5 million in tax year 1998. Assuming that this addition modification does translate directly into increased taxable income of this amount, corporate income tax revenues would increase an additional $1.3 million for tax year 1998, distributed across fiscal years as discussed above.

State Property Tax

This bill reclassifies cables, lines, poles, and towers as operating personal property, rather than operating real property. About 55% of current operating real property of telecommunications companies are cables, lines, poles, and towers. The estimated base for tax year 1999 is $2.3 billion, resulting in a loss of special fund revenue of $2,638,000 in fiscal 1999 since operating personal property is not subject to the State property tax. This loss is estimated to increase by 5% per year.

Sales and Gross Receipts Taxes

Exempting sales of Internet access service from the gross receipts tax would result in a negligible loss of revenue. The provision of Internet access service by telecommunications companies is a small portion of the market.

Local Revenues: Local revenues would increase because a portion of corporate income tax revenues distributed to the TTF are ultimately distributed to local governments. In fiscal 1999, the increase is estimated at $1.0 million, statewide, and in fiscal 2000, the increase is estimated at $915,000. This revenue increase would grow at an estimated 5% per year.

Local revenues would decline in the three jurisdictions with an ad valorem tax on telephone service (Anne Arundel County, Baltimore City, and Baltimore County) since the PSC is required to reduce telephone rates reflecting the elimination of the gross receipts tax from the rate base. The revenue loss depends on how the PSC reduces rates, and on the extent to which rates decline through increasing competition.

Small Business Effect: The significant impact of this bill is the imposition of the corporate income tax on operating revenues of local exchange carriers, resulting in an increase of the corporate income tax burden of about $14 million annually. This burden would be shared between local exchange carriers, shareholders, and customers. The extent to which this burden falls on small businesses cannot be reliably estimated, but it is expected to be minimal.

Information Source(s): Department of Assessments and Taxation, Office of the Comptroller (Revenue Administration Division, Compliance Division), Department of Fiscal Services

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