HB 1130

Department of Legislative Services

Maryland General Assembly
1999 Session

FISCAL NOTE
Revised

House Bill 1130 (Delegate Hixson, *et al.*)
Ways and Means

Prepaid Telephone Calling Arrangements - Taxation

This bill exempts a "prepaid telephone calling arrangement" from the gross receipts tax. Instead, the sales and use tax is imposed on the purchase of a prepaid telephone calling card arrangement. The sales and use tax does not apply to the use of a taxable service obtained by using a prepaid telephone calling arrangement.

The bill is effective January 1, 2000.

Fiscal Summary

State Effect: Indeterminate but potentially significant increase in general fund and special fund revenues. No effect on expenditures.

Local Effect: Local revenues could increase by an indeterminate amount.

Small Business Effect: Potential meaningful.

Fiscal Analysis

State Effect:

Gross Receipts Tax

Under current law, prepaid calling arrangements are not taxed at the time of purchase. However, when an individual uses the prepaid calling arrangement, the minutes used are subject to the 2% gross receipts tax which is paid by the telephone company and remitted to the Department of Assessments and Taxation. To the extent that all the minutes on the prepaid calling arrangement may not be used, the gross receipts tax does not capture the full amount of that arrangement.

It is the responsibility of the phone companies to track the usage of the arrangements in order to assess the gross receipts tax. Studies indicate that there is currently only about a 40% compliance rate for the payment of the gross receipts tax due to the difficulty in tracking and ascertaining to which state to pay the tax. Therefore, only about 40% of the usage is taxed and remitted back to the State.

Because of the compliance issue, the effect of exempting prepaid telephone calling arrangements from the gross receipts tax cannot be reliably estimated at this time. For illustrative purposes, it is estimated that 44 million prepaid telephone calling arrangements were sold in Maryland in fiscal 1999 although only about 17.6 million of the arrangements were subject to the 2% gross receipts tax. Exempting the 17.6 million prepaid telephone calling arrangements from the 2% current receipts tax for six months in fiscal 2000, would result in a decrease in general fund revenues of approximately $176,000 in fiscal 2000, or $352,000 on an annualized basis.

Income Taxes

The phone companies are currently able to deduct the total amount of gross receipts tax paid from their Maryland income, which reduces their federal adjusted gross income. Consequently, federal and State taxes are reduced because of the reduction. Under the bill, Maryland telephone companies would no longer be able to subtract the gross receipts tax from their income. Therefore, general fund revenues could increase to the extent that the companies' corporate income taxes paid will increase.

The revenue from the corporate income tax accrues to both the general fund and special funds, with approximately 75% going to the general fund, and 25% to the Transportation Trust Fund (TTF).

Sales and Use Tax

Under the bill, the total cost of the prepaid telephone calling arrangement would be subject to the current 5% Maryland sales and use tax. This would eliminate the tracking problem that exists under current law. Using the example discussed above, imposing a 5% sales and use tax on 44 million prepaid telephone calling arrangements beginning in January 2000 will result in a general fund revenue increase of $1.1 million in fiscal 2000, or $2.2 million on an annualized basis.

It should be noted that individuals could order more time on their prepaid telephone calling arrangements from out-of-state telephone companies (otherwise known as recharges). It would be difficult to collect the sales tax on those recharges.

Net Effect

The net effect of all three components is an indeterminate but potentially significant increase in State revenues. Using the example above, exempting prepaid telephone calling arrangements from the gross receipts tax and imposing the 5% sales and use tax on the arrangements could increase State revenues by at least $924,000 in fiscal 2000, or $1.8 million on an annualized basis.

Local Effect: Local revenues would increase to the extent the phone companies' corporate income taxes paid increase since a portion of the TTF is distributed to local governments.

Small Business Effect: Small businesses that are providers of telecommunications services would be positively impacted by this bill.

Information Source(s): Department of Assessments and Taxation, Comptroller of the Treasury (Bureau of Revenues Estimates), Public Service Commission

Fiscal Note History: First Reader - March 11, 1999
ncs/jr Revised - Enrolled Bill - April 29, 1999

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