Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 1182 (Delegate Hixson)
Ways and Means and Economic Matters

Communications Services - Taxation and Regulation

This bill alters the current taxation of telecommunications services for State tax purposes, by (1) repealing the public service company franchise tax currently imposed on persons engaged in a telephone business; and (2) imposing the State sales and use tax on the sale of "communications services." The bill also makes changes to the current cable television franchise agreements entered into by local governments by prohibiting them from entering into or renewing a cable franchise agreement that includes a fee. The bill specifies the procedure for the collection and distribution of fees owed to a local government under an existing cable franchise agreement. Finally, the bill authorizes the Public Service Commission (PSC) to enter into a statewide cable franchise agreement beginning in January 1, 2010

The bill takes effect July 1, 2009.

Fiscal Summary

State Effect: General fund revenues increase by $115.9 million in FY 2010 and Transportation Trust Fund (TTF) revenues increase by $6.5 million. Future year revenues reflect the various growth projections for each component of the bill. General fund expenditures increase by $379,600 in FY 2010. Future year expenditures reflect annualization and inflation.

($ in millions)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
GF Revenue	$115.9	$114.4	$113.4	$112.8	$111.3
SF Revenue	$6.5	$6.4	$6.3	$6.3	$7.7
GF Expenditure	$.4	$.5	$.5	$.5	$.5
Net Effect	$122.0	$120.3	$119.2	$118.6	$118.5

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

Local Effect: Potentially significant decrease in local government revenue from cable television franchise agreements. The revenue decrease depends on current franchise agreements and when the agreements expire.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The bill (1) repeals the public service company franchise tax imposed on persons engaged in the telephone business; and (2) imposes the State sales and use tax on communications services.

Communications services are defined by the bill as the electronic transmission; conveyance; or routing of audio, data, information, video, voice, or other signals, including cable services, to a point or between points, by or through any cable, electronic, radio, satellite, optical, microwave, or other medium or method, regardless of the protocol used for the transmission or conveyance. This includes the connection, movement, change, or termination of communications services; detailed billing of communications services; sale of directory listings in connection with a communications service; central office and custom calling features; voice mail and other messaging services; and directory assistance.

The bill specifies that the State sales and use tax does not apply to a charge for the provision of air-to-ground radiotelephone services, as defined by federal law; a communications services provider's internal use of communications services in connection with its business of providing communications services; or charges for property or other services that are not part of the sale of communications services, if the charges are stated separately from the charges for communications services.

The bill specifies that, as of January 1, 2010, a local government may not enter into or renew a cable franchise that includes a fee. Franchise is defined by the bill as an authorization issued by a franchising authority for the construction or operation of a cable system, a telecommunications system, or other facility in the public rights-of-way. It includes the initial authorization or renewal of an authorization; a negotiated cable franchise or an ordinance cable franchise; or a franchise, permit, license, resolution, contract, certificate, or agreement.

The bill authorizes PSC to enter into a statewide cable franchise agreement with any cable operator beginning January 1, 2010. PSC must determine the scope of and any applicable franchise agreement fees.

Current Law:

Public Service Company Franchise Tax

The State imposes a 2% tax on the gross revenues of a person (public service company) engaged in a telephone business in Maryland, including resellers of local or long distance landline telephone service. The tax base includes revenues from basic landline local telephone service (local exchange and inter-exchange service) and long distance telephone service. The tax base does not include revenues generated from wireless phone service or Internet phone service (VOIP), Internet access service, telephone service obtained using a prepaid calling arrangement, and cable or satellite television services.

Sales and Use Tax

The State sales and use tax rate is 6% and is imposed on the sale of tangible personal property and selected services. With regards to telecommunications service, the tax base includes, the sale of telecommunications equipment (including equipment used by telephone companies to provide telecommunications services), wireless telecommunications service, 900-type telephone service, a telephone answering service, pay-per-view television service, custom calling service provided in connection with basic telephone service, and prepaid telephone calling arrangements. The tax base does not include landline local or long distance telephone service, VOIP, cable television, satellite television, or Internet access service. Exemptions from the sales and use tax include purchases by governmental and charitable organizations and sales for resale.

Background: Telecommunications tax reform in Maryland has been proposed several times in the last 20 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.

Most recently, 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: In total, State revenues increase by $122.4 million in fiscal 2010 and by $119.0 million in fiscal 2014. The impact on State revenues of each of the bill's major provisions is discussed below.

Repeal of the Franchise Tax on Telecommunications Providers

In fiscal 2007, telephone companies paid approximately $48.2 million in franchise taxes. While telecommunications 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. Due to these factors, the revenue loss from the elimination of the franchise tax is estimated at $48.2 million in fiscal 2010, with the revenue loss declining by about 2% per year thereafter.

Imposition of Sales Tax on Retail Telecommunications Purchases, Cable and Satellite TV

Replacing the 2% franchise tax with a 6% State sales tax on communications services will increase the revenue base (before adjustments) by 300%. 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. The lost revenue associated with these groups is estimated at approximately 18% of commercial franchise tax collections.

In addition, certain services, such as custom calling features (*e.g.*, Caller ID), "900" calling services, and telephone answering services are already subject to the sales tax but are also included in the gross receipts subject to the franchise tax. Any estimate of increased sales taxes from the transfer of telecommunications taxation from the franchise tax to the sales tax under this bill must therefore be reduced by the sales of these services, which are already collected under the sales tax. These services are estimated at approximately $33.5 million in fiscal 2010, and growing at a rate of approximately 10% per year.

The bill also imposes the sales tax on cable and satellite television services. Based on current State and national data it is estimated that sales taxes on cable and satellite television services will be $79 million and $20.5 million, respectively. The estimate assumes 6% annual growth in revenues from cable television sales and 2.5% annual growth in satellite television sales.

Net Impact

Exhibit 1 shows the estimated revenue generated from imposing the sales tax on the various components of the bill. Chapter 10 of 2008 altered the distribution of sales and use tax revenues by requiring that, for fiscal 2009 through 2013, 5.3% of revenues be distributed to TTF. Beginning in fiscal 2014, the amount distributed to TTF increases to 6.5%. Accordingly, the effect of the bill will increase general fund revenues by approximately $115.9 million and TTF revenues by $6.5 million in fiscal 2010. **Exhibit 2** shows the distribution of sales tax revenues between the general fund and TTF.

Exhibit 1
Estimated Sales and Use Tax Revenues Under HB 1182
($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Net Telecom[1]	$70.7	$62.9	$55.4	$48.0	$40.9
Cable TV	79.4	84.2	89.3	94.6	100.3
Satellite TV	20.5	21.0	21.5	22.1	22.6
Total Sales Tax Revenue	**170.6**	**168.1**	**166.1**	**164.7**	**163.8**
Current Franchise Tax	(48.2)	(47.3)	(46.4)	(45.6)	(44.7)
Net Sales Tax Revenues	**$122.4**	**$120.8**	**$119.7**	**$119.1**	**$119.0**

[1]After deductions for sales to government and currently taxed telecommunications services; also includes VOIP.

Exhibit 2
Distribution and Increased Sales and Use Tax Revenue
($ in Millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
General Fund	$115.9	$114.4	$113.4	$112.8	$111.3
TTF	6.5	6.4	6.3	6.3	7.7
Total	**$122.4**	**$120.8**	**$119.7**	**$119.1**	**$119.0**

State Expenditures: The bill grants PSC the authority to establish cable television franchise agreements for the State of Maryland. Currently, each county establishes its own agreement with local cable providers. PSC is authorized to determine the scope of the statewide franchise agreement and set the applicable franchise fees. Cable franchise agreements include numerous provisions including certification requirements, technical standards, network build out schedules, outage management, maintenance and repair, quality of service, content availability, availability of public interest channels, tariff filing and processing procedures, billing and customer care, investigate customer complaints, unfair or destructive competitive practices, and the setting of just and reasonable rates.

As a result, PSC's general fund expenditures increase by $379,600 in fiscal 2010, which accounts for a 90-day start-up delay. This estimate reflects the cost of hiring two regulatory economists, one staff counsel, one general counsel, and three administrative specialists to administer the cable franchise program. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses

Salaries and Fringe Benefits	$336,453
Operating Expenses	43,148
Total FY 2010 State Expenditures	**$379,601**

Future year expenditures reflect full salaries with 4.4% annual increases and 3% employee turnover and 1% annual increases in ongoing operating expenses.

Local Fiscal Effect: Prohibiting local governments from charging a fee when entering into a cable franchise agreement may result in a significant decrease in local revenue. Currently, in many jurisdictions cable television companies are required to enter into a franchise agreement with the local government in order to provide cable television services to the area. These agreements require a fee to be paid by the cable company to reimburse the county for maintaining public rights-of-way. **Exhibit 3** shows the counties with franchise agreements and the estimated revenue yields from these agreements. In fiscal 2009, local governments will collect $51.3 million in revenue from franchise agreements.

Local governments would begin losing this revenue with the expiration of existing franchise agreements with cable providers. Baltimore County indicates its franchise agreements expire in 2016. Montgomery County's current agreements expire in 2013, 2014, and 2021. Somerset County's agreements expire in 2015. However, it is assumed at least some portion of the new fees charged by PSC for statewide franchise agreements would be distributed to local governments to cover rights-of-way maintenance and other associated costs.

Small Business Effect: Residences and small businesses would incur a larger share of the tax increase under the bill versus the impact on large businesses. The vast majority of revenue collected by the franchise tax on telecommunications firms is associated with residential and small business telephone lines. Increasing the effective tax rate from 2% to 6% on telecommunications charges paid by small businesses may have a meaningful impact on an individual firm if the firm was heavily dependent on telecommunications (as a share of its costs). Large businesses already pay a disproportionately smaller share of the franchise tax because they utilize private line networks to minimize the number of leased land telephone lines.

Exhibit 3
County Cable Television Franchise Agreements and Estimated Revenues
Fiscal 2008-2009

County	Franchise Fee	FY 2008 Revenues	FY 2009 Revenues	Number of Companies	County Franchise
Allegany	2% - 5%	$332,774	$320,000	3	Y
Anne Arundel	5%	6,976,017	6,830,000	4	Y
Baltimore City	5%	5,290,052	5,000,000	1	Y
Baltimore	5%	11,181,858	11,868,000	2	Y
Calvert	5%	984,342	970,000	1	Y
Caroline	0%	0	0	0	N
Carroll	5%	981,457	1,050,000	1	Y
Cecil	5%	285,743	299,100	3	Y
Charles	5%	1,302,786	1,457,400	1	Y
Dorchester	0%	0	0	2	Y
Frederick	n/a	N/A	N/A	1	N
Garrett	0%	0	0	3	N
Harford	3%	1,208,176	1,332,500	2	Y
Howard	5%	3,775,214	3,463,025	2	Y
Kent	3%, 5%	18,208	19,000	2	Y
Montgomery	5%	9,849,000	10,584,000	1	Y
Prince George's	5%	6,156,509	6,279,600	2	Y
Queen Anne's	5%	288,682	260,000	1	Y
St. Mary's	5%	690,540	725,000	2	Y
Somerset	3%	97,875	90,000	3	Y
Talbot	2%	22,219	22,000	2	Y
Washington	0%	0	0	0	N
Wicomico	5%	761,365	700,000	3	Y
Worcester	0%	0	0	3	N
Total		**$50,202,817**	**$51,269,625**		

Source: Maryland Association of Counties

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Maryland Association of Counties, Baltimore and Somerset counties, Comptroller's Office, Public Service Commission, Department of Legislative Services

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