

DEPARTMENT OF TAXATION

2005 Fiscal Impact Statement

1. **Patron** Samuel A. Nixon, Jr.

2. **Bill Number** HB 2880

3. **Committee** House Finance

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

4. **Title** Virginia Communications Sales and Use Tax

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would restructure the state and local communications taxes and fees by replacing the current state and local communications taxes and fees with a centrally administered Communications Sales and Use Tax and a uniform statewide E-911 tax.

The tax restructuring would be effective July 1, 2006.

6. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

Expenditure Impact:

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Positions</i>	<i>Fund</i>
2004-05	\$0	0	CSUTTF
2005-06	\$1,415,718	0	CSUTTF
2006-07	\$157,877	3	CSUTTF
2007-08	\$154,886	3	CSUTTF
2008-09	\$159,086	3	CSUTTF
2009-10	\$163,429	3	CSUTTF
2010-11	\$167,867	3	CSUTTF

7. **Budget amendment necessary:** Yes.

Item(s): 286, Department of Taxation

8. **Fiscal implications:**

Administrative Costs

As this bill would require the Department to implement and administer a new tax, the Department will incur costs of \$1,415,718 in Fiscal Year 2006, \$157,877 in Fiscal Year 2007, \$154,886 in Fiscal Year 2008, \$159,086 in Fiscal Year 2009, \$163,429 in Fiscal Year 2010 and \$167,867 in Fiscal Year 2011 to implement this bill, including three full time employees and the necessary systems changes. These costs would be paid from the Communications Sales and Use Tax Trust Fund ("Fund"). As the Department would incur substantial costs in Fiscal Year 2006 to implement this bill before any revenues from the new tax are deposited into the Fund, a budget amendment to allow the Department to

obtain a treasury loan which will be repaid when there are sufficient revenues in the Fund, would be necessary.

Revenue Impact

Chapter 634 (House Bill 1174) was enacted in the 2004 General Assembly Session to provide a framework for restructuring the state and local telecommunications taxes. House Bill 1174 declared the intent of the General Assembly to enact legislation in the 2005 Session repealing (a) the local consumer utility tax on telephone services; (b) the local gross receipts tax in excess of 0.5 percent on public service companies; (c) the Virginia Relay Center Assessment; and (d) the state and local E-911 taxes and fees. These taxes and fees would be replaced with a yet-to-be-named tax on all retail telecommunications services to be imposed at a rate approximating the combined state and local sales tax rate and a uniform statewide 911 tax and fee not to exceed \$0.75 on all lines. House Bill 1174 directed the Auditor of Public Accounts (APA) to determine whether revenues from the proposed tax would be sufficient to replace revenues from the repealed taxes. In his Study of the Telecommunications Tax Structure Report, issued October 15, 2004, the APA stated that:

[P]rojected revenue, based on maximum rates in the legislation, does not generate sufficient revenues to fully replace all revenues resulting from the current state and local taxes and fees that are subject to repeal. There is an estimated \$34 million deficiency between the current revenue base of \$391 million and the projected revenues of \$357 million.

In order to meet this deficiency, House Bill 2880 would expand the base of the new tax beyond what was contemplated by 2004 House Bill 1174 to include cable and satellite television services. Although much of the revenues from the imposition of the new tax on cable television services would be dedicated to satisfying the contractual obligations of cable television providers to pay cable franchise fees to localities, representatives of the industries supporting this proposal state that the additional revenues from imposing the new tax on cable and satellite television services would be sufficient to eliminate the estimated deficiency.

For several reasons, the Department of Taxation is not able to verify these conclusions. The APA was charged with issuing a report that was based solely on one fiscal year and does not make any assumptions regarding the revenue impact of this proposal in future years. Due to rapidly changing technology and increased price competition, future revenues are difficult to predict. Additionally, the APA was not requested to include cable and satellite television in its report.

9. Specific agency or political subdivisions affected:

All counties, cities and towns.
Department of Taxation
Department for the Deaf and Hard of Hearing
State Corporation Commission
Auditor of Public Accounts

10. Technical amendment necessary: Yes.

In order to reflect that the new tax would be based on sales of communications services, rather than sales of property, the following technical amendments are suggested:

Page 10, Line 605, after: that the
Strike: property
Insert: service

Page 11, Line 624, after: of the
Strike: property
Insert: service

11. Other comments:

Current Communications Taxes

Communications services, such as landline and wireless telephone service and cable television service, are currently subject to one or more of the following state and local taxes and fees:

- Local Consumer Utility Tax on landline and wireless telephone service;
- Local E-911 tax on landline and wireless telephone service;
- State E-911 fee on wireless telephone service;
- Virginia Relay Center Assessment on landline and wireless telephone service for the costs of a telephone relay service for the hearing impaired;
- The portion of the local Business, Professional, and Occupational License (BPOL) tax on public service companies exceeding .5% currently billed to customers in some grandfathered localities;
- Local cable television franchise fees;
- Local Video Programming Excise Tax on cable television services; and
- State and local right-of-way fees on landline telephone service.

Satellite television providers are generally not subject to these taxes. Cable television operators subject to a local cable franchise fee are currently exempted from state and local right of way fees.

Proposal

Repeal of Current Communications Taxes

Effective July 1, 2006, this bill would repeal the following state and local taxes and fees:

- Local Consumer Utility Tax on landline and wireless telephone service;
- Local E-911 tax on landline telephone service;
- Virginia Relay Center Assessment on landline and wireless telephone service for the costs of a telephone relay service for the hearing impaired;
- The portion of the local Business, Professional, and Occupational License (BPOL) tax on public service companies exceeding .5% currently billed to customers in some grandfathered localities; and
- Local Video Programming Excise Tax on cable television services.

Communications Sales and Use Tax

This bill would impose a new Virginia Communications Sales and Use Tax ("Communications Tax"). The Communications Tax would be a state tax administered and enforced by the Department. The Communications Tax would be imposed on customers of communications services at the rate of 5% of the sales price of the services. The new tax would appear as a line item on customers' bills.

Communications services subject to the tax would include:

- Landline and wireless telephone services (including Voice Over Internet Protocol);
- Paging;
- Cable television;
- Satellite television;

The Communications Tax would be collected by all communications services providers ("Providers") with sufficient contact, or nexus, with the Commonwealth to be subject to the tax using the same rules that apply to the retail sales and use tax. Providers would register with the Department in the same manner as sales tax dealers. Each Provider would separately state the amount of the tax and add that tax to the sales price of the service. Thereafter, the tax would be a debt from the customer to the Provider until paid. All sums collected by a Provider would be held in trust for the Commonwealth. As with the retail sales and use tax, every Provider required to collect or pay the Communications Tax would be required to file with the Department a monthly return and remit the tax due on or before the twentieth day of the month following the month in which the tax is billed.

Providers would be allowed a dealer discount on the first three percent of the Communications Tax in the following percentages:

<u>Monthly Taxable Sales</u>	<u>Percentage</u>
\$ 0 to \$62,500	4%
\$ 62,501 to \$208,000	3%
\$ 208,001 and above	2%

The dealer discount on the Communications Tax would not become effective until the Auditor of Public Accounts ("APA") certifies that Communications Tax revenues collected in the fiscal year are at least equal to the Fiscal Year 2004 revenues from the taxes and fees that are amended or repealed by the bill plus the annual cost to the Department of administering the Communications Tax.

The bill would provide a mandatory procedure for customers to resolve erroneous billings of the Communications and E-911 taxes by writing their service provider.

The bill would provide accounting rules for transactions where services that are subject to different tax treatments are sold for a non-itemized charge. If the charge is attributable to services that are taxable and services that are nontaxable, the portion of the charge attributable to the nontaxable services would be subject to tax unless the communications services provider can reasonably identify the nontaxable portion from its books and records kept in the regular course of business.

For purposes of the Communications Tax, the sales price would not include the following:

- Excise taxes on communications services that are permitted or required to be added to the sales price of such service, if the tax is stated separately;
- A fee or assessment that is required to be added to the price of service if the fee or assessment is separately stated;
- Coin-operated communications services;
- Sale or recharge of a prepaid calling service;
- Air-to-ground radiotelephone services;
- A Providers' internal use of communications services in connection with its business of providing communications services;
- 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;
- Sales for resale; and
- Charges for communications services to the Commonwealth, any political subdivision of the Commonwealth, and the federal government and any agency or instrumentality of the federal government.

The following would not be considered taxable communications services:

- Information services;
- Installation or maintenance of wiring or equipment on a customer's premises;
- The sale or rental of tangible personal property;
- The sale of advertising, including but not limited to, directory advertising;
- Bad check charges;
- Billing and collection services;
- Internet access service, electronic mail service, electronic bulletin board service, or similar services that are incidental to Internet access, such as voice-capable e-mail or instant messaging;
- Digital products delivered electronically, such as software, downloaded music, ring tones, and reading materials; and
- Over-the-air radio and television service broadcast without charge by an entity licensed for such purposes by the Federal Communications Commission.

All sales by a provider would be subject to the Communications Tax until the contrary is established. The burden of proving that a sale of communications services is not taxable would be upon the provider unless it obtains an exemption certificate from the customer. Internet access service providers that purchase telecommunications services to provide Internet access would be authorized to use self-issued exemption certificates. Upon receipt of the certificate, the communications service provider would be relieved of any liability for the tax related to that sale. In the event the provider of Internet access uses the telecommunications service for any taxable purpose, the Internet access service provider would be required to pay the Communications Tax directly to the Department.

The Department would be authorized to allow a person who uses taxable communications services to pay the Communications Tax directly to the Department and waive the collection of the tax by the provider.

New E-911 Tax

The bill would also impose a new E-911 tax on landline telephone service. The E-911 tax would be state tax administered and enforced by the Department. The E-911 tax would be imposed on the end user of each access line at the rate of \$0.75 per access line. The new tax would appear as a line item on customers' bills. Providers would be allowed a dealer discount of three percent of the amount of the E-911 tax revenues. The state wireless E-911 fee would not be affected by this bill.

Cable Franchise Fees

This bill would prohibit any cable franchise agreement entered into or renegotiated after July 1, 2006 from including a franchise fee. Cable franchise agreements in effect as of

July 1, 2006 would remain in effect until their expiration. However, instead of paying franchise fee payments directly to localities, franchisees would include with their monthly Communications Tax remittance to the Department a report listing by locality the franchise fees due that month. The Department would distribute the franchise fees to localities after deducting its administrative costs and the costs of the Telecommunications Relay Service but prior to making other calculations and distributions from the Fund. Localities would retain the right to audit cable franchisees and to otherwise enforce franchise agreements.

Virginia Relay Center

This bill would authorize the Department to disburse funding for the Telecommunications Relay Service for the costs of the telephone relay service for the hearing impaired. Any funds held by the State Corporation Commission for the Telecommunications Relay Service as of July 1, 2006 would be transferred to the Fund.

Auditor of Public Accounts Report

This bill would require the APA to determine the amount of revenues received by every locality for Fiscal Year 2005, at rates adopted on or before July 1, 2003, for each of the following taxes and fees:

- Consumer Utility Tax on landline and wireless telephone service;
- E-911 tax on landline and wireless telephone service;
- The portion of the local Business, Professional, and Occupational License (BPOL) tax on public service companies exceeding .5% currently billed to customers in some grandfathered localities;
- Cable television franchise fees; and
- Video Programming Excise Tax on cable television services.

Communications Sales and Use Tax Trust Fund

The revenues from the Communications Tax and the E-911 tax would be collected and remitted monthly by communications services providers to the Department and deposited into a new non-reverting fund known as the Communications Sales and Use Tax Trust Fund ("Fund").

After transferring moneys from the Fund to the Department of Taxation to pay for the direct costs of administering the Communications Tax, the moneys in the Fund would be allocated and distributed to localities after payment (1) to the Department of Deaf and Hard-of-Hearing to fund the telephone relay service center and (2) any franchise fee amount due to localities in accordance with any cable television franchise agreements in effect as of July 1, 2006. The localities' share of the net revenue would be distributed as soon as practicable after the end of the month.

During the first year in which distributions are made from the Fund, the net revenue distributable to localities would be apportioned and distributed to each locality (the "base amount") as follows:

- any town with a population of less than 500 would receive \$2,000 annually;
- any town with a population of at least 500 but no more than 1,499 would receive \$5,000 annually;
- any town with a population of at least 1,500 but no more than 3,500 would receive \$10,000 annually;
- any town with a population in excess of 3,500 that received no funds in fiscal year 2004 would receive \$12,500 annually.
- The remainder of the Fund would be divided among the remaining counties, cities and towns according to the percentage of the local consumer utility tax on landlines and wireless, E-911, business license tax in excess of 0.5 percent, cable franchise fee, video programming excise tax, local consumer utility tax on cable television each received in Fiscal Year 2005 from local tax rates adopted on or before July 1, 2003. An amount equal to the total franchise fee paid to each locality with a cable franchise existing on the enactment date of this section at the rate in existence on July 1, 2006 would be subtracted from the amount owed to the locality prior to the distribution of moneys from the Fund.

Distributions made from the Fund in year two and each year thereafter in which the Fund revenues increase would begin with the base amount and would be increased as follows:

- The base amount for each town with a population of 3,500 or less would be increased by the same percentage that the Fund revenues increased over the previous year.
- The remaining increase would be distributed among the remaining localities based on the percentage of the telecommunications taxes and fees it received in Fiscal Year 2005 from tax rates adopted on or before July 1, 2003.

Distributions made from the Fund in year two and each year thereafter in which the Fund's revenues decrease from one year to the next would begin with the base distribution amount:

- The base amount for each town with a population of 3,500 or less would be decreased by the same percentage that the Fund revenues decreased from the previous year.
- The remainder of the Fund would be divided among the remaining localities according to the percentage of the telecommunications taxes and fees it received in Fiscal Year 2005 from tax rates adopted on or before July 1, 2003.

For the purposes of the Comptroller making the required transfers, the Tax Commissioner would make a written certification to the Comptroller no later than the twenty-fifth of each month certifying the Communications Tax revenues received in the preceding month. Within three calendar days of receiving such certification, the Comptroller would make the required transfers to the Fund. Any errors made in any distribution, or adjustments that are otherwise necessary, would be made in the distribution for the next month or for subsequent months.

Public Rights-of-Way Fee

This bill would require all cable television providers to pay the state Public Rights-of-Way fee. The fee would be collected from subscribers and remitted monthly to the Department for deposit into the Fund.

Possible ITFA Impact

There is some risk that the taxing prohibitions contained in the Internet Tax Freedom Act ("ITFA") may be applicable to this bill. However, any conflicts between the provisions of this bill and the ITFA would need to be resolved by the courts. Nonetheless, current levels of revenue would be preserved because this bill contains a "revival clause" that would restore the current law that is being changed by this bill if any provision is determined to be invalid by the courts.

Other Legislation

Senate Bill 1335 is identical to this bill.

cc : Secretary of Finance

Date: 2/1/2005 JEM