JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2008 Session

Bill Number: HB924 as Introduced
Review Requested By: Delegate Purkey

This bill would provide an income tax credit of up to $10 million for the purchase and installation of wireless and broadband equipment in certain areas of the Commonwealth. It would also restore a sales and use tax exemption for tangible personal property that was sold or leased to a telecommunications company in order to render a public service. Restoring the sales and use tax exemption in full would reduce State revenues by at least $28.5 million and up to $41 million.

JLARC staff concur with the fiscal impact statement. The reduction to the General Fund due to both the income tax credits and the sales and use tax exemption, when the bill is fully effective in FY 2012, could be at least $38 million and up to $51 million.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:

Philip A. Leone
Director

JLARC offers Fiscal Impact Reviews in accordance with Item 21D of Chapter 847 (2007 Acts of Assembly). JLARC Fiscal Impact Reviews do not comment on the merits of the bill under review.

Bill Summary:

This bill would provide a nonrefundable individual and corporate income tax credit to taxpayers who purchase and install wireless and broadband equipment in order to provide communications services, including Internet access, to rural areas within the Commonwealth. The total amount of tax credits granted to all taxpayers could not exceed $10 million per tax year. Taxpayers would be required to apply for the credit by making an application to the Department of Taxation. If the applications for the credit exceeded the $10 million amount, the Department would prorate the money according to the total amount of tax credits each individual taxpayer was applying for.

In addition, this bill would provide a sales and use tax exemption for tangible personal property that was sold or leased to a telecommunications company for use or consumption by such a company directly in rendition of its public service. This exemption would be phased in over three years.

The tax credit portion of this bill would be effective for taxable years beginning on and after January 1, 2008. The sales and use tax exemption portion would phase in beginning January 1, 2009.

Discussion of Fiscal Implications:

The total reduction to the State General Fund as a result of HB 924, when fully effective in FY 2012, would be a minimum of $38 million and could be $51 million or more annually.

Income Tax Credit. The bill is designed to cap the income tax credit to a maximum of $10 million per year. The Department of Taxation's estimate of the cost of a part-time employee to administer and allocate the tax credit appears reasonable.

Sales and Use Tax Exemption. Department of Taxation staff estimated the potential revenue impact of the proposed restoration of the sales and use tax exemption for telecommunication companies to be approximately $41 million if the exemption were fully restored. Department of Taxation staff report that this estimate was derived from three sources: (1) tax surcharges on customers' bills; (2) a survey of telecommunications companies asking them what they paid in sales taxes or on purchases subject to the sales tax; and (3) estimates based on plant expansion data from telecommunications companies filed with the State Corporation Commission (SCC).

Tax Surcharges. Telecommunications companies lost this exemption in 2004, but some currently have the authority to impose a separate line item surcharge on customers' bills in order to recoup the taxes paid as a result of the repeal of the exemption. According to Department of Taxation staff, large telecommunications companies reported these surcharges total approximately $10 million per year. This total surcharge amount can be regarded as identical to the amount of sales and use taxes paid by this subset of large companies.

Survey Data. Department of Taxation staff also had access to proprietary survey data from other relatively large telecommunications (mostly wireless) companies. In this survey the companies reported what they paid in sales taxes or the purchase price of goods subject to the sales tax. This amount resulted in a total of approximately $18 million.

From these first two sources alone, the total amount of $28.5 million can be regarded as a minimum revenue impact of restoring the exemption, because it is based on information from a subset of (the largest) telecommunications companies in Virginia. But it does not include <u>all</u> telecommunications companies.

Estimates Based On Plant Expansion Data. To estimate what the remainder of telecommunication companies paid in sales taxes, Department of Taxation staff used cost data associated with plant expansions that these telecommunications companies filed with the SCC. All telecommunication companies must file with the SCC cost data associated with plant expansions. From the first two sources, Department of Taxation staff derived ratios of sales taxes paid to plant expansion costs. These ratios were then multiplied by the plant expansion costs from the companies which were not included in the first two sources. This third component accounted for the remaining $12 million of the estimated revenue impact of restoring the exemption.

However, this third component is more subject to uncertainty than the other two components of the revenue impact estimate. In particular, different telecommunications companies use different systems of accounting in reporting their costs of plant expansions. The estimation technique employed by Taxation staff was an attempt to adjust for these differences.

Overall, JLARC staff concluded that the revenue impact of fully restoring the exemption could range from at least $28.5 million to as much as $41 million or possibly more. The $28.5 million amount is based on self-reported data from the largest telecommunications companies in Virginia, and is not as subject to variation as the remaining $12 million estimate may be. Further, these estimates could also fluctuate if (1) future purchases subject to the sales tax are not of the same amounts as those in the past, or (2) inflation is more explicitly taken into account. However, making adjustments to take these factors into account would be highly speculative.

Phasing-In. The exemption to the sales and use tax would be phased-in over three years. The full effect would occur in FY 2012.

<u>Budget Amendment Necessary</u>: Yes. There would be a reduction in FY 2009 and FY2010 General Fund revenue estimates.

<u>Agencies Affected:</u> Department of Taxation

Date Released, Prepared By: 01/31/2008; Greg Rest

JLARC offers Fiscal Impact Reviews in accordance with Item 21D of Chapter 847 (2007 Acts of Assembly). JLARC Fiscal Impact Reviews do not comment on the merits of the bill under review.