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THE JOINT STANDING COMMITTEE
ON TAXATION RELATING TO LD 699,
AN ACT TO REALIGN THE TAX LAWS
OF THE STATE AS THEY RELATE
TO TELECOMMUNICATIONS

JANUARY, 1986

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REPORT
OF
THE JOINT STANDING COMMITTEE ON TAXATION
RELATING TO L.D. 699,
AN ACT TO REALIGN THE TAX LAWS OF THE
STATE AS THEY RELATE TO TELECOMMUNICATIONS

Background

Telecommunications was a relatively quiet subject until the last couple of years. The telephone industry was a highly regulated monopolistic structure which was easy to conceptualize and which permitted rather standardized policy decisions. Telephone and telegraph service, as a monopoly, was regulated on both the state and federal levels as to both prices that might be charged and services that could be offered.

However, the information revolution resulted in legal and technological developments which have made the "simple" telephone system a thing of the past. The anti-trust suit filed by the United States Department of Justice in the 1970's against A. T. & T., Inc. resulted in a consent decree ordering the divestiture by A.T.&T. of many of its subsidiary companies including the local operating companies, such as New England Telephone Company (NET) which provides local and intrastate toll services in Maine. While local telephone service would continue to be a monopoly, most other telecommunications services will be gradually opened to competition.

The breakup of the Bell telephone system as a result of divestiture, beginning in 1984, has turned easy concepts and

decisions to difficult ones. The framework for decision making is complicated not only by the complexity of the changes resulting from divestiture but also by the changing technology in the system and the diverse roles of various regulatory agencies.

Currently, the following conditions prevail:

	Interstate Calls	Intra-state toll Calls	Local Calls	Equipment
Regul. Agency	FCC	State PUC	State PUC	None
Regul.	Competition	almost no competition, but competition may be coming	no competition	de-regulated
Companies in Maine	AT & T GTE-Sprint others on way	Local phone Co:NET in most areas, independents in some		wide variation

The most troublesome aspect of the divestiture of the Bell system is its effect upon basic telephone rates. Currently, the prevailing thought maintains that long distance rates have contributed substantially to reducing the price of local service below its true cost, although the degree of contribution is a matter of lively debate. In a monopoly, it did not matter how costs were allocated. However, with the introduction of competition, AT&T is interested in reducing the price it must charge to provide competitive services such as interstate

services in order that it may reasonably compete with other companies which are entering the field. In order for interstate rates to be reduced, some costs previously allocated to long distance must now be allocated to the local system. This means increased costs for basic telephone service.

It has been estimated that re-allocation of costs could result in an increase in local rates of as much as 200% to 300% in the next several years. Such large increases in rates threaten the concept of "universal service" which generally holds that it is desirable for all persons who want a telephone to be able to afford one because of the value that it provides not only to the individual but by broadening the ability of the system to reach the largest number of persons. If the threshold cost of entry to the system is increased significantly, it is envisioned that increasing numbers of persons would discontinue participation on the system.

Interstate long distance

New technology, including solid state circuitry and satellite and microwave transmission facilities have made great reductions in the cost of providing long distance service technically feasible. That makes increased economic efficiency of the system possible, especially on heavily used routes, and the FCC has allowed competition in the long distance market in order to capture that economic efficiency. These developments also provide economic incentive to large users to construct or participate in their own long distance systems unless long distance rates on the traditional system are kept low.

Access Charges and Customer Line Charges

Some portion of the costs of interstate telecommunications service is attributable to the local loop which is necessary to complete the long distance call. Before divestiture, the costs of the local loop were apportioned between local and long distance services in a manner which artificially increased the cost of long distance calls while decreasing the cost of local exchange service. When one company provided both services the allocation of those costs was not crucial, but now it is very important. In order for AT&T to compete with new companies providing long distance telecommunications, it must be able to offer rates which are not inflated by costs that are more appropriately be allocated to local services.

Since divestiture, the contribution of costs from the local loop to the long distance system has been accomplished in two different ways. Long distance carriers pay access charges to local exchange companies at a rate determined by the FCC. In addition, the FCC has proposed that the cost of local loop access ought to be gradually charged directly to the local subscriber. Originally, the FCC ordered that local subscribers pay a "customer access line charge" of \$4 per month for residential customers and \$6 for business customers. Following Congressional movement toward abolishing this charge the residential customer line charge was reduced by the FCC to \$1 per month. An increase to \$2 is scheduled for July 1986. Business customers continue to be charged the \$6 per month charge. Meanwhile, long distance toll rates can be reduced and,

as customer line charges are increased, the "access charges" previously paid by the interstate long distance carriers to the local carriers for access to the local loop (averaging 15 cents/minute) can be phased out. That will remove the past uneconomic suppression of long distance calling.

Intrastate Calls (Local & Long Distance)

At present, local and long distance calls within the state are for the most part carried by the same company, NET, which is regulated by the Maine PUC. Competition except in special cases has not been allowed but could be at some point in the future. Local exchange carriers argue that their rates must be kept low to avoid bypass of the local network by either customers or long distance carriers.

Taxation and Telecommunications

AT&T has presented LD 699, AN ACT to Realign the Tax Laws of the State as they Relate to Telecommunications for the purpose of equalizing its tax treatment relative to other long distance carriers with which it is now in competition. This bill would change several provisions of current tax law relating to telecommunications.

Several provisions of current law relate to the taxation of telecommunications services. Under the telephone and telegraph excise tax, telephone companies pay a graduated excise tax with a maximum rate of 7% of gross receipts. Telegraph companies pay a tax equal to 6% of gross receipts. Telephone companies

subject to the tax are defined as those "operating a telephone line for compensation." The excise tax is in lieu of property taxes upon pole, wires, machinery and equipment of the company. Land, buildings and towers remain subject to the tax.

Traditionally, AT&T, NET and other independent local exchange carriers have paid the telephone excise tax in Maine. Recently, GTE-Sprint began offering long distance services in the Portland area. GTE-Sprint interprets the term "telephone line" strictly. Since their own equipment does not include "lines" in the traditional sense, they do not consider themselves subject to the excise tax. The Bureau of Taxation has not suggested a contrary interpretation.

Currently, Maine's sales tax applies to calls originating and terminating in Maine. It does not apply to interstate calls. The sales tax also applies to the installation and use of telephone equipment. Therefore, if a customer chooses to lease a telephone from AT&T, a sales tax applies to that lease. Most other types of rentals are not subject to a sales tax.

The major change contemplated in LD 699 is to equalize the treatment of long distance services under the excise tax by restricting that tax to local exchange carriers. Exemption of AT&T from the excise tax would result in its formerly exempt property becoming subject to a local property tax. In order to account for the loss of revenue that would result, LD 699 also proposed to change the sales tax provisions relating to the rental of property. It would exempt from the sales tax sales of property to be used by the purchaser in a rental or leasing

business and would subject the subsequent rental or leases to a sales tax.

First Regular Session

The Taxation Committee considered LD 699 during the First Regular Session of the 112th Legislature. A public hearing and numerous work sessions were held on the bill. At that time the Committee made several decisions about the bill.

1. Excise tax. The Committee agreed that something needed to be done to remedy the unequal application of the excise tax to long distance carriers. However, the Committee decided that it would be more appropriate to extend the excise tax to include all long distance carriers rather than to exclude those carriers from the excise tax entirely.
2. Sales tax. AT&T stated that the sales tax provisions were included in the bill primarily to replace revenues that would be lost by the removal of long distance carriers from the excise tax. They were also concerned that the imposition of a sales tax on the rental of telephone equipment placed AT&T at a disadvantage with regard to other companies which were selling similar items. The Bureau of Taxation was unable to provide an estimate of the revenue gain that would result from the imposition of a sales tax on all rentals. The Committee received no general public comment on this provision of the bill and believed that many people who would be affected by it were unaware of its inclusion in LD 699. For these reasons the Committée

decided to drop the rental tax provision from the bill. The provision of the bill which would have extended the sales tax to interstate telephone calls was dropped by the Committee because the revenue was not needed as long as the excise tax on long distance carriers was not being eliminated.

3. Comsat. During the discussion of the extension of the excise tax, the Committee heard from a representative of the Comsat facility in Andover that an extension of the excise tax to that facility could hamper the company's effort to sell the facility. In addition, the exemption of Comsat property that would result from such an extension would also result in a substantial reduction in property taxes for the Town of Andover. Therefore, the Committee agreed to exclude revenues derived from an earth satellite facility from inclusion under the extended tax.

The Committee's discussion became bogged down by the consideration of the appropriate treatment of access charges. Prior to divestiture, revenues within the Bell system were apportioned according to a national agreement which resulted in each company being taxed on its portion of the total revenue. After divestiture, the FCC ordered that long distance companies must pay access charges to the local exchange companies to cover a portion of the cost of the local loop attributable to long distance services. These access charges are derived from revenues received by AT&T. When paid to NET, they again become

revenues to the local company. If both companies were required to include the amount of the access charges within gross revenues subject to taxation, those revenues would be taxed twice.

This result was not envisioned by the original telephone excise tax. In fact, in 1984, the first year after divestiture, AT&T deducted access charges from the base on which its tax was calculated. Although the law does not appear to authorize such a deduction, the tax form used by the State was not updated to take divestiture into effect and was somewhat ambiguous with regard to deductions.

During discussions at the end of the First Regular Session, both AT&T and NET wanted to be permitted to deduct the access charges from their taxable revenues. The Committee received confusing and often conflicting information about the results of such deductions, and it became apparent that the issue was sufficiently complicated to foreclose a decision in time for the end of the session. Therefore, the Committee requested and was granted permission to hold LD 699 until the Second Regular Session and to study the issue further.

Second Regular Session

During the Fall of 1985, the Committee held several meetings to discuss LD 699. It heard from the Bureau of Taxation, the Public Advocate's Office and several representatives of AT&T and NET, as well as representatives of GTE-Sprint, COMSAT and Kennebec Valley Reach, a non-profit reseller of

telecommunications services. The Committee developed a broadened and updated definition of telecommunications services which ought to be subject to the excise tax. That language is included in the amendment to LD 699 proposed by the Committee.

The Committee recognizes that the expansion of the scope of taxable entities may result in the exemption from local property tax of some of the property of telecommunications providers which were not previously covered. Article IV, Part 3, Section 23 of the Maine Constitution requires that the State reimburse municipalities for at least 50% of the property tax loss resulting from property tax exemptions enacted after April 1, 1979. Although it is not expected that the expansion will result in substantial increases in exempt property, it is not possible to estimate the liability of the State for municipal reimbursement because it is unclear the amount of property that will be newly included within the exemption.

The access charge issue was considered in some depth by the Committee. A presentation on access charges was made by AT&T and responded to by NET and others. As a result of this consideration it became apparent that local rates would not be affected by which company received the deduction for access charges. If AT&T received the deduction, it would be able, subject to FCC approval, to reduce its rates on long distance services. If NET received the deduction, it would be able to charge, subject to FCC approval, lower access charges to AT&T and help to prevent AT&T bypassing the NET system.

The Committee also decided to discontinue the 6% rate for telegraph services which would now be included under the definition of "telecommunications service."

Recommendations

The Committee recommends no changes at this time in sales tax provisions relating to telecommunications. It also recommends that the telephone and telegraph excise tax be equalized and expanded to cover a modernized definition of providers of "telecommunications service" and that access charges be deducted by the person receiving them. A chart describing these changes and proposed legislation is attached.

STATE OF MAINE
112TH LEGISLATURE
SECOND REGULAR SESSION

COMMITTEE NEW DRAFT WITH NEW TITLE OF L.D. 699, AN ACT to Modernize the Telephone Excise Tax.

Sec. 1. 36 MRSA c. 363 is repealed.

Sec. 2. 36 MRSA c. 364 is enacted to read:

CHAPTER 364

TELECOMMUNICATIONS SERVICE

§2691. Persons Taxable

Every person providing telecommunications service shall pay to the State Tax Assessor an annual excise tax for the privilege of conducting a telecommunications business in this state.

§2692. Amount of tax

The amount of the annual excise tax on persons providing telecommunications service is as follows: when the total gross operating revenues of a person from the provision of telecommunications service originating or terminating in this state or billed to a person in this state during the calendar year preceding the year in which the tax is assessed on the person exceed \$1,000 and do not exceed \$5,000, the tax is 1 1/4% of the total gross operating revenues; when the total gross operating revenues exceed \$5,000 and do not exceed \$10,000, the tax is 1 1/2% of the total gross operating revenues; when the total gross operating revenues exceed \$10,000 and do not exceed \$20,000, the tax is 1 3/4% of the total gross operating revenues; when the total gross operating revenues exceed \$20,000 and do not exceed \$40,000, the tax is 2% of the total gross operating revenues; and so on, increasing the rate of tax 1/4 of 1% for each additional \$20,000 or fractional part thereof, of the total gross operating revenues, provided that the rate may in no event exceed 7% of the total gross operating revenues.

§2693. Returns

Every person providing telecommunications service shall annually, on or before the last day of January, return to the

APPENDIX A

State Tax Assessor, signed by the person responsible for the fiscal affairs of the provider, a statement of its total gross operating revenues from the provision of telecommunications service within the state during the preceding year ending December 31st, together with payment of tax in accordance with section 2692. A final reconciliation return shall be filed on or before March 31st covering the prior calendar year. The tax shall be a lien on the property of the provider, and on its franchise, and upon the property used by it in providing telecommunications service. This lien takes precedence over all other liens.

§2694. Definitions

As used in this chapter, unless the context otherwise indicates, the following terms have the following meanings:

1. Gross operating revenues. "Gross operating revenues" means the total revenues derived from the provision of telecommunications. "Gross operating revenues" does not include:

A. any amounts received by a person for the provision of facilities, services or network access utilized by another person in its provision of telecommunications service; or

B. any amounts attributable to international telecommunications service by means of satellite and an earth station located in Maine.

2. Telecommunications service. "Telecommunications service" means the transmission of any interactive two way electromagnetic communications including voice, image, data and information. Transmission of electromagnetic communications includes the use of any media such as wires, cables, including fiberoptical cables and television cable, microwaves, radio waves, light waves or any combination of those or similar media. "Telecommunications services" includes telegraph service. "Telecommunications service" does not include value added nonvoice services in which computer processing applications are used to act on the form, content, code and protocol of the information to be transmitted unless those services are provided under tariff approved by the Public Utilities Commission.

§2695. Books open to assessors

The State Tax Assessor or his duly authorized agent shall have access to the books of any person providing telecommunications service in this state, to ascertain if the required returns are correctly made. Any person refusing or neglecting to make the returns required by law or to exhibit to the State Tax Assessor, or to his duly authorized agent, books for the purpose aforesaid, or making returns which the president, clerk, treasurer or other person certifying those returns knows to be false shall be subject to a civil penalty of not less than \$1,000 nor more than \$10,000 payable to the state to be recovered in a civil action in any county into which the telecommunication service extends.

§2696. Limited property tax

The land, buildings and microwave towers or similar towers, owned by persons providing telecommunications service shall be taxed as real property in the municipality or unorganized territory in which they are situated.

The excise tax imposed by this chapter shall be in lieu of property taxes upon all other property used in the provision of telecommunications service which is subject to the tax imposed by this chapter including the poles, wires, conduits, cables, booths, central office equipment, and other machinery and equipment involved in providing telecommunication service.

STATEMENT OF FACT

The purpose of this new draft is to provide equal treatment for all persons providing telecommunications services by expanding the gross receipts tax on telephone companies to include all persons providing telecommunications service.

The amendment exempts persons providing telecommunications service by means of a satellite and earth station located in Maine. It includes telegraph services under the definition of telecommunications, thereby making telegraph services subject to the same maximum tax rate as applies to other telecommunications services. The amendment also provides that access charges and revenues derived from the provision of telecommunications service to another such provider for resale will be deducted by the person receiving them.